87-600

No.

Supreme Court, U.S.
FILED
OCT 13 1987
JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1987

THE VARIABLE ANNUITY LIFE INSURANCE COMPANY, ET AL., PETITIONERS

v.

BEVERLY J. OTTO, INDIVIDUALLY, AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED, RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTION PRESENTED

Whether a traditional fixed annuity that is subject to extensive regulation by state insurance commissioners is a "security" within the meaning of the federal securities laws because it also includes a discretionary "excess interest" component.

PARTIES TO THE PROCEEDING AND RULE 28.1 STATEMENT

Petitioners, who were defendants and appellees in the courts below, are The Variable Annuity Life Insurance Company (VALIC), Charles T. Bauer, Mortimer M. Caplin, Henry Chauncey, Harry C. Copeland, Jr., W. Thomas Fiquest, Frederick M. Glass, Grinnel Morris, Roy T. Parker, Jr., Robert S. Phillips, Michael E. Puyans, W. Dawson Sterling, Benjamin N. Woodson, Philip G. Davidson III, Andrew Delaney, Joe F. Flack, Richard H. Hanneman, Harold S. Hook, George F. Reed, Robert L. Baldwin, Stephen D. Bickel, Terrence J. Conlan, Joe D. Heusi, John D. Hogan, William B. Pardue, William B. Phelps, Michael J. Poulos, Robert O. Purcifull, Diane G. D'Agostino, Gregory C. Wilcox, The Variable Annuity Marketing Company (VAMCO), The Variable Annuity Life Insurance Company Separate Account One, and American General Corporation. American General Corporation indirectly owns all of the stock of VALIC; VAMCO is a wholly-owned subsidiary of VALIC. The subsidiaries owned by American General Corporation, and the joint ventures in which they are involved, are listed in App., *infra*, 65a-67a.

Respondent Beverly J. Otto was the named plaintiff in the district court and the appellant in the court of appeals. She was certified by the district court as the representative of a class consisting of all Illinois participants in the fixed annuity program of The Variable Annuity Life Insurance Company between October 17, 1975, and August 2, 1982 (App., *infra*, 3a).

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Variable Annuity Life Insurance Company, *et al.*, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The original opinion of the court of appeals (App., *infra*, 1a-25a), its opinion on rehearing (App., *infra*, 26a-32a), and its order amending its opinion on rehearing (App., *infra*, 33a-34a) are reported at 814 F.2d 1127. The opinion of the district court granting summary judgment to petitioners on respondent's federal securities claim (App., *infra*, 35a-47a) is reported at 611 F. Supp. 83. The opinion of the district court denying respondent's motion for reconsideration (App., *infra*, 48a-56a) is reported at 107 F.R.D. 635.

JURISDICTION

The judgment of the court of appeals was entered on April 15, 1987 (App., *infra*, 57a-58a). A petition for rehearing was denied on June 15, 1987 (App., *infra*, 59a). On August 28, 1987, Justice Stevens granted an extension of time to and including October 13, 1987, within which to file a petition for a writ of certiorari (App., *infra*, 64a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Section 3(a)(8) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(8), Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), Sections 1 and 2 of the McCarran-Ferguson Act, 15 U.S.C. §§ 1011 and 1012, and SEC Rule 151, 17 C.F.R. § 230.151, are set forth at App., *infra*, 60a-63a.

STATEMENT

This case involves a fixed annuity sold by petitioner The Variable Annuity Life Insurance Company (VALIC). Annuities provide benefits for the life of the annuitant; just as life insurance protects against the risk of premature death, an annuity protects against the risk that the policyholder will exceed his actuarially-determined life expectancy and thereby outlive his accumulated savings.

Annuities traditionally have been regarded as insurance products and are extensively regulated by state insurance commissioners. Concomitantly, federal law excludes annuities from the scope of the securities acts. While some instruments denominated as "variable annuities" have been held to be a "security" because they have the essential elements of an equity investment, fixed annuities have been widely understood to be insurance and not a "security." The decision below represents the first time that a fixed annuity has been held to be subject to the federal securities laws.

A. VALIC's Fixed Annuity.

VALIC, a Texas stock insurance company authorized to do business in all 50 states and the District of Columbia, sells annuities that qualify for special tax benefits under Section 403(b) of the Internal Revenue Code (26 U.S.C. § 403(b)). During the period at issue, VALIC offered two types of annuities: variable and fixed. Under the variable annuity, VALIC did not guarantee either the principal or the rate of return. Rather, the funds related to this annuity were placed in a Separate Account that was segregated from VALIC's general assets and invested in a diversified portfolio of common stocks and other equity-type investments. The value of the variable annuity was solely a function of the success of the investments in the Separate Account. App., *infra*, 9a.

VALIC's variable annuity was largely designed as a hedge against inflation over the period of the annuity contract. VALIC (through a wholly-owned subsidiary) marketed the variable annuity on the basis of long-term capital appreciation, and its literature made clear the nature of this type of annuity and the benefits and risks that it entailed. The variable annuity was registered as a security under the Securities Act of 1933, 15 U.S.C. § 77f, and the Separate Account was registered as an investment company under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 *et seq.* Furthermore, VALIC's subsidiary was registered as a "broker/dealer," and the agents who sold the variable annuity were registered as National Association of Securities Dealers (NASD) representatives. App., *infra*, 38a.

Beginning in 1964, VALIC also offered a fixed annuity, which guaranteed that not less than all principal (premium payments), accumulated at a specified minimum rate of interest, would be applied to the purchase of an annuity at actuarially-determined rates. VALIC's fixed annuity paid 4% interest per year for the first 10 years

and 3½% interest annually thereafter. In contrast to the variable annuity, VALIC's promotional materials explained and emphasized the conservative nature of the fixed annuity. App., *infra*, 3a, 7a.

In addition to the guaranteed payment of both principal and specified interest, VALIC's fixed annuity provided that the company could, at its option, pay so-called "excess interest"—interest above the rate guaranteed in the policy. Whether to declare "excess interest" and in what amount were entirely within the discretion of VALIC; annuitants had no entitlement to or assurance of the provision of "excess interest" benefits. On the other hand, once an "excess interest" payment was declared and credited to an annuitant's account, it was vested and could not be taken away. App., *infra*, 30a.

Fixed annuity funds were included in VALIC's general assets and invested, pursuant to state insurance law requirements, in long-term debt-type instruments such as mortgages and bonds. The fixed annuity was not registered under the Securities Act, nor was VALIC registered as a "broker/dealer" or an investment company. Likewise, to sell this policy, VALIC's agents were not required to be registered as NASD representatives and had to be licensed only by state insurance departments. App., *infra*, 8a, 38a.

B. The Proceedings Below.

1. Respondent is the representative of a class of all Illinois participants in VALIC's fixed annuity program between October 17, 1975, and August 2, 1982 (App., *infra*, 3a). She brought this action in the United States District Court for the Northern District of Illinois on August 2, 1982, alleging that VALIC's fixed annuity was a "security" and that VALIC had violated Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j (b)) and SEC Rule 10b-5 thereunder (17 C.F.R.

§ 240.10b-5).[1] Specifically, respondent contended that VALIC failed to disclose the method it used to calculate the applicable discretionary "excess interest" payments. App., *infra*, 36a.

The district court granted summary judgment to petitioners, holding that the fixed annuity was not a "security" (App., *infra*, 36a-42a). Relying primarily on this Court's decisions in *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (*VALIC I*), and *SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202 (1967), the district court concluded that the fixed annuity was "more properly viewed as an insurance product than as an investment contract" and therefore was outside the scope of the federal securities laws (App., *infra*, 37a).

In reaching this conclusion, the district court determined that the company "bears the investment risk" in the fixed annuity because it "guarantee[s] the return of the participants' contributions plus interest," and that "the economic inducement is indeed the 'usual insurance basis of stability and security' rather than growth through investment" (App., *infra*, 40a). In particular, the district court rejected respondent's argument that "the guaranteed rates of interest were hardly enough to attract anyone to the contract and that the incentive was the discretionary interest payable." *Id.* at 41a n.5. The court also referred to a letter sent to annuity issuers by the Securities and Exchange Commission, which stated that "neither the [issuer's] general account nor any interests therein are generally subject to the provisions of the 1933 or 1940 Acts" (*id.* at 42a & n.6).

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[1] Respondent also included counts against VALIC under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001 *et seq.*, the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961 *et seq.*, and state law. Those counts were dismissed by the courts below and are not involved in this petition.

2.a. On respondent's appeal, the Seventh Circuit initially affirmed the district court's holding that VALIC's fixed annuity was not a security (App., *infra*, 5a-13a). Applying the analysis of *VALIC I* and *United Benefit*, the court of appeals held that VALIC's fixed annuity fell within Section 3(a)(8) of the Securities Act of 1933 (15 U.S.C. § 77c(a)(8)), which excludes from the federal securities laws "[a]ny insurance or endowment policy or annuity contract or optional annuity contract."

The court of appeals first explained that VALIC had guaranteed principal and interest on the fixed annuity "[r]egardless of the investment success" of the company or general "economic conditions" (App., *infra*, 9a). Moreover, funds related to the fixed annuity "were mingled with the company's general assets" rather than maintained in a separate account and were "invested primarily in debt-type securities" (*ibid.*). And "VALIC promoted its fixed annuity as insurance" and designed it to provide "a long-term accumulation of funds for retirement through compound interest" (*ibid.*). Thus, the Seventh Circuit held that VALIC's fixed annuity possessed the customary features of an annuity and "appealed to potential participants on the usual insurance bases of stability and security" (*id.* at 8a).

The court of appeals expressly rejected respondent's contention that the guaranteed rate of interest under the fixed annuity (4% per year for the first 10 years and 3½% per year thereafter) was so minimal that it left the investment risk on the participant and imposed no significant investment risk on VALIC. The court explained that, although the rate was low, "it was not so low that we can say it placed the investment risk on the policyholder in a way substantial enough to make the fixed annuity a security" (App., *infra*, 9a).

Finally, the court of appeals noted that its decision was "supported" by the recently released SEC Rule 151,

17 C.F.R. § 230.151, 51 Fed. Reg. 20,254 (June 4, 1986), which provides certain annuities with a "safe harbor" exclusion from the federal securities laws (App., *infra*, 10a).[2] The court remarked that "VALIC's fixed annuity satisfies all of the requirements of Rule 151" (*id.* at 12a) because VALIC was subject to the supervision of state insurance commissioners, because the fixed annuity was not marketed primarily as an investment, and because VALIC assumed the investment risk by guaranteeing principal and specified interest payments and by agreeing not to modify the "excess interest" rate more frequently than once per year. *Id.* at 12a-13a.

b. Respondent sought rehearing of the court of appeals' decision. In addition, petitioners moved to modify the opinion on the ground that the court had been mistaken in assuming that VALIC's fixed annuity satisfied the requirement of Rule 151 that the insurer agree not to modify the "excess interest" rate more often than once a year. Although VALIC in fact had not changed the rate of "excess interest" on existing deposits at any time during the relevant period, it had the discretion to do so (on a prospective basis) and therefore did not meet this provision of the "safe harbor" rule.

Following supplemental briefing, the court of appeals granted rehearing and reversed its prior decision, holding that VALIC's fixed annuity *was* a "security" and thus was subject to the federal securities laws (App., *infra*, 26a-32a).[3] The panel made virtually no attempt to rec-

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[2] Rule 151 took effect on June 4, 1986, and therefore was not directly applicable to the period at issue in this litigation.

[3] The court of appeals suggested that VALIC had failed initially to make clear that its fixed annuity did not satisfy the one-year "excess interest" requirement of Rule 151 (App., *infra*, 28a). While not material to the question presented in this Petition, we do note, for the reasons fully explained by VALIC in its briefs below, that the terms and operation of the "excess interest" provision were accurately and sufficiently described in VALIC's sub-

oncile this about-face with its previous analysis or to explain why, apart from the SEC's "safe harbor" rule, the fixed annuity constituted a "security" under the statutes and the decisions of this Court. Instead, it rested its revised ruling entirely on the fact that the "excess interest" rate was not guaranteed to remain unchanged for at least a year—a factor, the court acknowledged, that had never been "relied on previously in court decisions distinguishing securities from insurance products" (*id.* at 31a). Accordingly, while purporting to recognize that SEC Rule 151 is a "safe harbor" provision rather than a definitional standard for the term "security" (*ibid.*), the court held that VALIC's fixed annuity was a "security" because it did not meet one of the elements of the Rule.

REASONS FOR GRANTING THE PETITION

Under longstanding principles of federalism, and pursuant to express statutory provision, insurance and annuities have been excluded from the scope of the federal securities laws and instead have been subject to the exclusive regulation of the states. As recognized by both the district court and the court of appeals in its original opinion, VALIC's fixed annuity bore the essential characteristics of an excluded "annuity" rather than a covered "security" within the meaning of federal law. Nonetheless, the Seventh Circuit concluded on rehearing that the fixed annuity was a security simply because it failed to satisfy one of the requirements of the SEC's rule for a "safe harbor" exemption from the securities laws.

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missions to the court. Indeed, the court of appeals, in its opinion on rehearing, recognized that VALIC's opening brief had argued only that the fixed annuity "'*largely* satisfies'" Rule 151 (*id.* at 29a (emphasis added)), and the district court's opinion expressly noted that "the discretionary interest, of course, was just that—discretionary—and could be varied or omitted at any time" (App., *infra*, 41a n.5). Moreover, VALIC itself pointed out the court of appeals' error by moving to modify the original opinion.

The court of appeals' erroneous ruling threatens to have immediate and severe consequences for the insurance industry and state insurance commissioners. Insurance companies, which have predicated their fixed annuity businesses on the understanding that they were not covered by the federal securities laws, suddenly find themselves exposed to enormous potential liability and ongoing regulation under those laws. Furthermore, it would be inconsistent with the scheme of exclusive state authority over the business of insurance for the SEC and federal courts (and juries) now to superimpose federal requirements on state insurance systems. Such drastic results should not be permitted to occur based on the decision of a single court of appeals.

Indeed, for insurance companies that sell annuities in states within the Seventh Circuit, the ruling below is effectively of nationwide scope. Compliance with most of the requirements of the federal securities laws—such as the various registration requirements for securities, for "broker/dealers," and for investment companies—can occur only on a national basis; if, for example, VALIC and other companies must register their fixed annuities as "securities" under the Securities Act of 1933 in order to do business in Illinois, Wisconsin and Indiana, that registration will cover all such annuities regardless of where they are sold in the United States. For these companies, therefore, the decision of the court of appeals has substantially the same effect as a decision of this Court: it is, as a practical matter, binding everywhere, not just in the states that the Seventh Circuit comprises.

In *SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202, 207 (1967), the Court granted certiorari to decide whether a particular annuity was a "security" because of "the importance of the issue" and "the need for clarifying the implications" of the seminal decision in *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65

(1959) (*VALIC I*).[4] Precisely the same considerations warrant further review here.

A. The Court Of Appeals' Decision Will Have Immediate And Widespread Consequences That Will Adversely Affect The Insurance Industry, State Insurance Commissioners, The SEC, And Policyholders.

The court of appeals has held that a traditional insurance product, the fixed annuity, is in fact a "security" subject to the myriad requirements of the federal securities laws. This decision, if allowed to stand, will have widespread adverse consequences for the insurance industry, state insurance commissioners, the SEC, and policyholders. These regulatory burdens and economic dislocations should not be permitted to occur unless and until this Court rules that federal law requires such results.

The Seventh Circuit's decision is of enormous concern to a major segment of the insurance industry. As the American Council of Life Insurance (ACLI) explained in its brief (at 1 (emphasis added)) as *amicus curiae* in support of rehearing en banc in the court below:

> Most fixed-dollar annuity contracts and some forms of fixed-dollar life insurance (*e.g.*, universal life insurance) contain guarantees of principal and interest and "excess interest" features that have varying degrees of similarity to the guaranteed and excess interest provisions of the fixed annuity contract issued by [VALIC]. These contracts represent *a significant portion of the aggregate life in-*

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[4] As Professor Loss has explained, the analytical "difficulty" in this area of the law is that insurance and annuity plans lie along "a continuous spectrum"—from "pure insurance" on one side to "pure investment" on the other. L. Loss, *Fundamentals of Securities Regulation* 224 (1983). Annuities that are "in varying degrees * * * variable" (*ibid.*) fall between those poles.

surance and annuity business in force in the United States today.

In 1985, 10 million fixed-dollar individual annuities, involving $24 billion in present and deferred annual annuity payments, were outstanding. See American Council of Life Insurance, *Life Insurance Fact Book—1986*, at 39. Moreover, 33 million people were covered under private pension plans funded by fixed-dollar group annuity contracts; these plans received $35 billion in contributions during that year and paid out benefits of $10 billion. *Id.* at 57. And there were also 7 million universal life policies in force, representing $564 billion of insurance. *Id.* at 29.

As ACLI's *amicus curiae* brief pointed out (at 9, 12 (emphasis added)), a large number of these annuity (and insurance) policies do not qualify for "safe harbor" treatment under SEC Rule 151:

> At the time that Rule 151 was adopted, * * * *both the industry and the Commission understood that many annuity contracts (and all life insurance contracts) would fall outside the safe harbor for one or more reasons.*
>
> * * * * * *
>
> In commenting on proposed Rule 151, the Council advised the Commission that several aspects of the proposal, including the investment risk standards, would, if adopted, compel most issuers of fixed annuities to rely directly upon the statutory exclusion in Section 3(a)(8) rather than seek the added regulatory comfort afforded by Rule 151. Inasmuch as the rule was adopted in substantially the same form in which it was proposed, *most issuers of fixed annuity contracts have, in fact, elected to remain outside the safe harbor.*

Thus, a substantial portion of the insurance industry has been thrown into jeopardy and confusion by the deci-

sion below. The industry has sold millions of policies on the understanding that fixed annuities like VALIC's are not subject to the federal securities laws. That reasonable business expectation—which is of "vital" importance to the insurance industry's ability to project liabilities and risks (see *Allied Structural Steel Co.* v. *Spannaus*, 438 U.S. 234, 246-247 (1978))—should not be lightly and precipitously upset. See, *e.g.*, *FDIC* v. *Philadelphia Gear Corp.*, 106 S. Ct. 1931, 1938 (1986); *BankAmerica Corp.* v. *United States*, 462 U.S. 122, 130-133 (1983).

For the insurance industry, the changes required under the court of appeals' decision will be far-reaching and immediate. An insurance product marketed nationwide, such as VALIC's fixed annuity, plainly cannot be treated as a "security" solely within the Seventh Circuit. Therefore, unless insurance companies were simply to cease doing business within the Seventh Circuit, which is not a feasible option, they will have to comply with this decision across the United States.

If "excess interest" annuities are securities, they will have to be registered under the Securities Act of 1933, 15 U.S.C. §§ 77e *et seq.* Insurance companies and their agents will have to qualify as "broker/dealers" and NASD representatives under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78c(a)(4)-(5), 78o. And the companies also might have to conform to the requirements of the Investment Company Act of 1940 (see 15 U.S.C. §§ 80a-2(a)(17), 80a-3(a) & (c)(3)), which would necessitate significant changes in the corporate structure and business practices of the companies and burden the sale of these annuities.

Moreover, insurance companies will be exposed to potential retroactive liabilities of enormous proportion. As this case illustrates, the decision below encourages multi-

year class actions seeking substantial damages based on the alleged failure of insurance companies to comply with federal securities provisions that they quite reasonably understood not to apply to their sale of annuities. In addition, Section 12(1) of the 1933 Act (15 U.S.C. § 77*l*(1)) imposes absolute liability for the sale of unregistered "securities" and entitles a purchaser to seek rescission plus interest; such relief would nullify the actuarial determinations and risk-pooling arrangements on which the annuity plan was based. And the Investment Company Act provides that if the issuing firm is found to be an unregistered "investment company," its sales of the annuity—indeed, all of its securities transactions in managing its portfolio of general assets—would be illegal as a matter of federal law. See 15 U.S.C. §§ 80a-7, 80a-46(b).

The court of appeals' ruling also dramatically and directly implicates the interests of the state and federal governments. As discussed in more detail below (see pages 24-28, *infra*), application of the federal securities laws to VALIC's fixed annuity and similar products will interfere with the exclusive authority of state insurance commissioners over the business of insurance. By the same token, as companies issuing this type of annuity seek to comply with the applicable registration requirements for "securities," for "broker/dealers," and for "investment companies," the SEC will be confronted with a significant and unanticipated demand on its limited regulatory resources.

Finally, the Seventh Circuit's decision will impair the interests of annuity policyholders. The court's ruling will unquestionably increase insurance companies' costs of doing business, which will make annuities more expensive for consumers and limit the availability of these policies. Furthermore, if fixed annuities are "securities," they might no longer be covered by state insurance guaranty funds, which protect policyholders in the event an

insurance company becomes insolvent (see page 27, *infra*). On the other hand, the court's extension of the federal securities laws to fixed annuities will provide policyholders with little if any additional protection from fraud, since state law already prohibits false and misleading statements by insurance companies (see page 25, *infra*).

Given the nature of the insurance business and the comprehensiveness of the federal securities laws, the court of appeals' decision will have a permanent, immediate, nationwide impact. Accordingly, this Court's review is essential to restore the balance between the state and federal regulatory schemes that has been disrupted by the decision below—a decision that, as we now discuss, is plainly incorrect.

B. The Court Of Appeals Erred In Holding That VALIC's Fixed Annuity Was A "Security" Subject To The Federal Securities Laws.

The applicability of the Securities Act of 1933 and the Securities Exchange Act of 1934 depends upon the term "security." [5] For two reasons, VALIC's fixed annuity was not a "security" under those Acts.

First, Section 3(a)(8) of the 1933 Act excludes from the securities laws "[a]ny insurance or endowment policy or annuity contract or optional annuity contract" issued by a corporation subject to the supervision of the

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[5] See Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1); Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10); see also Investment Company Act of 1940, § 2(a)(36), 15 U.S.C. § 80a-2(a)(36). This Court has "repeatedly ruled that the definitions of 'security' in § 3(a)(10) of the 1934 Act and § 2(1) of the 1933 Act are virtually identical and will be treated as such in our decisions dealing with the scope of the term." *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 686 n.1 (1985).

insurance commissioner of any state.[6] Moreover, this specific exemption is reinforced by the McCarran-Ferguson Act, 15 U.S.C. §§ 1011 *et seq.*, which establishes exclusive state regulation of the business of insurance. Thus, however broad the definition of "security" may be in general (see, *e.g.*, *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 686 (1985)), it does not extend to products with the attributes of an insurance policy or annuity contract.

Second, this Court's recent decisions establish that "Congress did not intend [the securities laws] to provide a comprehensive federal remedy for all fraud." *Landreth*, 471 U.S. at 687-688; see also *Marine Bank* v. *Weaver*, 455 U.S. 551, 556 (1982); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 478-480 (1977). Rather, in defining the term "security," the Court has been mindful that the securities laws should not be applied in a manner that would disrupt or intrude upon alternative regulatory systems. See *Marine Bank*, 455 U.S. at 557-559; *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 569-570 (1979). And this concern is particularly significant where the "extension of the federal securities laws would overlap and quite possibly interfere with state * * * law" (*Green*, 430 U.S. at 479). Here, application of the federal securities laws would directly and substantially interfere with the exclusive state regulation of insurance.

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[6] This Court, the SEC, and commentators have recognized that Section 3(a)(8) of the 1933 Act, while literally drafted as an exemption from the provisions of that statute, more broadly excludes insurance and annuities from the "securities" that are subject to the 1933 and 1934 Acts. See *Tcherepnin* v. *Knight*, 389 U.S. 332, 342 n.30 (1967); H.R. Rep. No. 85, 73d Cong., 1st Sess. 5, 15 (1933); SEC Release 33-6558, 49 Fed. Reg. 46,750, 46,753 (Nov. 28, 1984); L. Loss, *Fundamentals of Securities Regulation* 214 (1983).

1. *VALIC's Fixed Annuity Was An "Annuity" Rather Than A "Security" Under* VALIC I *And* United Benefit.

Although the federal securities laws exclude from their coverage any "annuity contract," this Court has held that some annuities are sufficiently similar to an equity investment (such as a mutual fund) that they constitute a "security." The Court's analysis in those cases demonstrates that VALIC's fixed annuity is a true "annuity" that is exempt from the securities acts.

In *VALIC I*, the Court held, 5-4, that VALIC's variable annuity was a "security" under the federal securities laws. The variable annuity did not guarantee either principal or interest, and the annuity premiums were pooled and placed in equity investments. Accordingly, the policyholders had "nothing * * * except an interest in a portfolio of common stocks or other equities" (359 U.S. at 72), and the benefit payments to which they were entitled "var[ied] with the success of the investment policy" (*id.* at 69).

The Court agreed that VALIC had assumed a mortality risk under the policy, which was one of the two requirements of an exempt annuity (359 U.S. at 70). However, it concluded that the second requirement—the company's assumption of an investment risk—was not satisfied because benefit payments depended entirely on the success of the equity portfolio and included no guaranteed fixed income (*id.* at 71-73):

> The difficulty is that, absent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company. * * * But * * * the concept of "insurance" involves some investment risk-taking on the part of the company. * * * "[I]nsurance" involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts.

Given these characteristics, the variable annuity involved "a very substantial and in fact predominant element of the business of an investment company * * * [that is] totally foreign to the business of a traditional life insurance and annuity company, as traditionally regulated by state law" (*id.* at 81 (Brennan, J., concurring)).

In *United Benefit*, the Court held that a deferred or optional "flexible fund" annuity was a "security." In that case, the annuity premiums were maintained in a separate account, segregated from the insurer's general assets, that was invested in common stocks to produce capital gains. Each policyholder had a proportionate share in the separate account, and benefits were a function of the investment success of the fund; however, the company also guaranteed a minimum alternative cash value based on a percentage of net premiums (*i.e.*, premiums less specified deductions). The company advertised that the annuity provided "a chance to share in the growth of the country's economy" by reaping the benefits of a professional investment program. See 387 U.S. at 204-206 & n.3.

Because of the operation of the deferred annuity, the Court held that the "pay in" portion of the contract could be separated from the "pay out" portion and that the former was a covered "security" rather than an exempt "annuity." The Court found that the company did not bear a mortality risk under the "pay in" part of the policy (387 U.S. at 211) and that the annuity "appeal[ed] to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management" (*ibid.*). Given these findings, the Court concluded that the existence of a guaranteed cash value—which in fact represented a minimal guarantee that was unlikely to come into operation (*id.* at 208-209 & nn. 10, 12)[7]—did not

[7] Among other things, the cash value guarantee in *United Benefit* neither ensured *any* return on the investment nor protected

"by itself" convert the contract from a "security" into an "annuity" (*id.* at 211).

In the present case, the Seventh Circuit did not hold that VALIC's fixed annuity failed to meet the criteria of an "annuity" laid down in *VALIC I* and *United Benefit*. Thus, the court of appeals did not dispute that VALIC assumed a mortality risk under the annuity contract. Nor did it conclude that VALIC was not bearing a substantial investment risk; on the contrary, the court noted that the express guarantee of principal and specified interest regardless of investment success or economic conditions entailed a significant investment risk (App., *infra*, 8a-9a).[8] Likewise, the court found that VALIC's fixed annuity rested "on the usual insurance bases of stability and security" (*id.* at 8a) and that VALIC "promoted its fixed annuity as insurance" with the objective of "a long-term accumulation of funds for retirement through compound interest" (*ibid.*). Finally, the court acknowledged that premiums for the fixed annuity "were mingled with the company's general assets," rather than segregated in a separate fund, and were "invested primarily in debt-type securities" (*ibid.*).

In light of these determinations, it is apparent that VALIC's fixed annuity had the essential characteristics of a traditional insurance product as set forth in this

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against the outright loss of a significant portion of principal. In this case, by contrast, VALIC's fixed annuity guaranteed both principal in full and a specified rate of return. App., *infra*, 38a.

[8] By setting the maximum interest rate an insurance company may assume in establishing reserves for annuity contracts, state insurance laws effectively regulate the maximum interest rate that may be guaranteed under a fixed annuity. See, *e.g.*, Ill. Rev. Stat. ch. 73, § 835 (1985); Tex. Ins. Code Ann. § 3.28 (Vernon 1981). Such a limitation ensures that the guaranteed rate does not exceed what can be safely and reliably maintained over the life of the annuity. The fact that fixed annuities guarantee interest that is below market rates of return is thus an integral feature of this insurance product.

Court's decisions. Because of the guarantee of principal and specified interest, the annuity policy satisfied the "concept of 'insurance,'" which requires that there be "some investment risk-taking on the part of the company" and payment of "at least some fraction of the benefits * * * in fixed amounts" (*VALIC I*, 359 U.S. at 71). Unlike the variable annuity in *VALIC I*, the fixed annuity policy represented a "true underwriting of risks" (*id.* at 73). The Seventh Circuit therefore was plainly wrong in concluding that, despite these attributes, the fixed annuity contract was transformed into a "security" simply because of the existence of the discretionary "excess interest" provision—an element, as the court below candidly conceded, that has not been "relied on previously in court decisions distinguishing securities from insurance products" (App., *infra*, 31a).[9]

Because fixed annuities that guarantee principal and a specified return without "excess interest" are rarely sold in the market today, the "excess interest" fixed annuity is the closest available type of policy to the paradigm of a fixed annuity that Congress clearly intended to be excluded from federal securities regulation. The court of appeals' expansion of the securities laws to apply to "excess interest" fixed annuities thus is wholly at odds with the admonition in *VALIC I* that courts should not "freeze the concepts of 'insurance' or 'annuity' into the mold they fitted when these Federal [Securities] Acts were passed." 359 U.S. at 71; see also *id.* at 76 (Brennan, J., concurring); *id.* at 101 (Harlan, J., dissenting).

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[9] See Kroll and Cohen, *The Insurance-Security Identity Crisis*, 46 Geo. Wash. L. Rev. 790, 794, 801-805 (1978); Recent Decisions, 61 Mich. L. Rev. 1374, 1381 (1963); Annotation, *What Annuity Contracts are Subject to Securities Act of 1933—Federal Cases*, 18 L.Ed.2d 1557, 1560 (1967). See also Fleming, *Universal Life: Finding a Safe Harbor Under The Securities Act of 1933*, 34 Fed. Ins. Coun. Q. 421 (Summer 1984).

In contrast to the ruling below, the Tenth Circuit has correctly applied *VALIC I* and *United Benefit* to discretionary payment provisions. In *Olpin* v. *Ideal National Ins. Co.*, 419 F.2d 1250 (10th Cir. 1969), cert. denied, 397 U.S. 1074 (1970), the court held that life insurance policies containing bonus payments, which were set (above a prescribed minimum) in the discretion of the company based on its investment earnings, were not a "security" because the company rather than the policyholders assumed the investment risk (419 F.2d at 1261-1263). The Tenth Circuit's determination that an insurance product containing a discretionary payment provision was not a "security," even though the payment level reflected the company's investment experience, cannot be squared with the Seventh Circuit's decision in this case.

2. *The Court Of Appeals' Decision Rests On A Serious Misapplication Of SEC Rule 151.*

In its opinion on rehearing, the court of appeals made no attempt to reconcile its decision with *VALIC I* and *United Benefit* or even with its own earlier analysis applying the principles of those decisions. Instead, the court's ruling was based entirely on SEC Rule 151 and the failure of VALIC's fixed annuity to satisfy one of the criteria of that "safe harbor" provision. This ruling represents a manifest misapplication of Rule 151.

SEC Rule 151, 17 C.F.R. § 230.151, 51 Fed. Reg. 20,254 (June 4, 1986), is an administrative "safe harbor" that excludes from the federal securities laws any annuity that satisfies its requirements.[10] The Rule is designed "to

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[10] These requirements are that (a) the annuity be issued by a corporation subject to the supervision of the state insurance commissioner, (b) the insurer assume the investment risk under the contract (as defined below), and (c) the annuity not be marketed primarily as an investment. The insurer assumes the investment risk for purposes of the "safe harbor" if (1) the value of the contract does not vary with the investment experience of a separate account, (2) the insurer for the life of the contract guaran-

provide greater certainty" (51 Fed. Reg. at 20,254) in the application of the securities laws by exempting those annuities that are "clearly" (*id.* at 20,255) covered by the insurance provision in Section 3(a)(8) of the 1933 Act.

In promulgating Rule 151, the SEC made unmistakably clear that it is "merely a 'safe harbor,' not an all-inclusive definition purporting to encompass every annuity contract that falls within the section 3(a)(8) exclusion" (51 Fed. Reg. at 20,255). Accordingly, Rule 151 "does not attempt to identify the outer limits of section 3(a)(8)" (*ibid.*). As the Commission emphasized, "[w]hile compliance with rule 151 will assure 'non-security status,' *failure to comply with the rule would not mandate 'security status' for an annuity product*" (emphasis added); rather, "an insurer offering a contract that, for one reason or another, does not satisfy all of the rule's conditions may still rely directly on section 3(a)(8), albeit with no Commission assurance that the contract is covered by the section 3(a)(8) exclusion" (*ibid.*).

Nevertheless, the court of appeals gave *no* reason for holding VALIC's fixed annuity to be a "security" other than the fact that the "excess interest" rate was not guaranteed for one year, as Rule 151 requires for "safe harbor" protection. See App., *infra*, 29a-31a. The court on rehearing did not independently analyze the investment risks under the policy to determine whether the fixed annuity fell within the statutory exemption of Sec-

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tees the principal and a specified rate of interest that meets a prescribed minimum, and (3) the insurer guarantees that any rate of interest in excess of the specified rate will not be modified more frequently than once per year. App., *infra*, 62a-63a. It is this last "excess interest" condition of the "investment risk" requirement that was the basis for the court of appeals' decision on rehearing that VALIC's fixed annuity was a "security" because it did not meet all of the terms of Rule 151.

tion 3(a)(8), as Rule 151 expressly contemplates. Nor did it take issue with the district court's determination (App., *infra*, 42a & n.6) that the SEC had indicated that annuities funded by an insurance company's general asset account were outside the scope of the federal securities laws. Instead, the Seventh Circuit seriously distorted the plain import of Rule 151 by turning the "safe harbor" shield into a statutory sword for limiting the scope of the insurance provision in Section 3(a)(8).[11]

To be sure, when petitioners raised this error below, the court of appeals amended its opinion to disclaim any such use of Rule 151. See App., *infra*, 33a-34a. But that verbal change does not in any way alter the substance of the court's decision. As the Seventh Circuit's opinion unquestionably demonstrates, the *sole* basis for the decision that VALIC's fixed annuity constituted a "security" was the annuity's failure to guarantee an "excess interest" rate for one year—a feature necessary only for purposes of coming within the SEC's "safe harbor." The decision does not even hint at any other ground for categorizing this insurance product as a "security." In so ruling, the court of appeals disregarded this Court's precedents and frustrated the SEC's explicit intent in promulgating Rule 151.

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[11] The court of appeals' erroneous application of Rule 151 is especially glaring in this case. The court did not dispute that VALIC's fixed annuity satisfied all but one of the many requirements for "safe harbor" treatment. The single exception—the one-year "excess interest" component of the investment risk criterion—is only a minor part of the overall regulation, as a fair reading of the Rule and accompanying SEC commentary reveals. Moreover, while VALIC had the right to vary the "excess interest" rate more often than once a year, *in fact it never did so*, and the rate applicable to existing contributions remained unchanged throughout the relevant period. Thus, VALIC's fixed annuity fell short of the requirements of Rule 151 only in the most subsidiary and technical respect.

3. *The Court Of Appeals' Decision Is Inconsistent With The Congressional Scheme Of Exclusive State Regulation Of Insurance.*

The court of appeals' decision also directly interferes with the states' exclusive authority to regulate the business of insurance. Such a result cannot be reconciled with recent rulings of this Court on the proper interpretation of the federal securities laws or with the vital policy of federalism to which Congress has consistently adhered in this area.

In a number of decisions this Court has held that the term "security" must be defined in light of alternative regulatory regimes that Congress intended would apply. In *International Brotherhood of Teamsters* v. *Daniel*, *supra*, for example, the Court, in ruling that a compulsory, noncontributory pension plan is not a "security," reasoned that the "existence of this comprehensive legislation [ERISA] governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to [such plans]" (439 U.S. at 569). Likewise, in *Marine Bank* v. *Weaver*, *supra*, which held that a certificate of deposit issued by a federally regulated bank is not a "security," the Court emphasized the "important fact" that the banking laws provide a "comprehensive set of regulations governing the banking industry" and protect the purchaser against the risk of the issuer's insolvency (455 U.S. at 558).[12] Similar considerations underlie other decisions that have restricted the reach of the federal securities laws in recognition of the regulatory requirements and remedies that exist under state law. See, *e.g.*, *Santa Fe Industries*,

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[12] In its brief as *amicus curiae* in *Marine Bank*, the government, in urging that the certificate of deposit was not a "security," argued (at 11 (emphasis added)) that "the regulation of the banking industry, *like that of the insurance industry*, emphasizes pervasive governmental supervision to substantially eliminate the risk of loss."

Inc. v. *Green*, 430 U.S. at 478-479; *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 40-41 (1977).

Here, too, a holding that VALIC's fixed annuity is a "security" would intrude upon an alternative scheme of regulation under state insurance laws. Indeed, the system of state regulation of insurance at stake in this case is of special significance, because states have long exercised sole authority over the business of insurance. This policy is reflected not only in the insurance exemption in Section 3(a)(8) of the 1933 Act, but also in the McCarran-Ferguson Act, 15 U.S.C. §§ 1011 *et seq.*, which declares that no Act of Congress shall be construed to "invalidate, impair, or supersede any laws enacted by any State for the purpose of regulating the business of insurance." 15 U.S.C. § 1012(b). Thus, courts construing Section 3(a)(8) must "start with a reluctance to disturb the state [insurance] schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements" (*VALIC I*, 359 U.S. at 68).

Without question, application of the federal securities laws to VALIC's fixed annuity would "invalidate, impair, or supersede" state regulation of the business of insurance. See *VALIC I*, 359 U.S. at 67 (application of the federal securities laws "would at least to a degree 'supersede' the state regulations since the Federal Acts prescribe their own peculiar requirements"). In fact, federal securities laws and state insurance regulation follow different approaches: the 1933 and 1934 Acts are based on the philosophy of full disclosure to permit the investor to make informed judgments, while state insurance codes are premised more on the substantive objective of policing the safety and reliability of insurance companies and the policies they issue. See, *e.g.*, *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 460 (1969); *VALIC I*, 359 U.S. at 77 & n.8, 90-91 (Brennan, J., concurring); see also note 12, *supra*.

Insurance companies such as VALIC are subject to comprehensive state regulation, and there are numerous areas of potential overlap or inconsistency between state insurance and federal securities laws. In this case, for example, respondent alleges that the company materially misled her by failing to disclose certain methods for calculating the applicable "excess interest." But the marketing and advertising of insurance policies, including the prohibition of false and deceptive practices, are an integral part of insurance regulation under the McCarran-Ferguson Act, and state insurance departments frequently review and approve annuity policies and supporting materials before they are disseminated to the public.[13] Furthermore, states presumably could go beyond the federal securities laws by affirmatively requiring the disclosure of this information in all cases (without regard to whether its omission was misleading in light of the statements that were made) or, alternatively, by prohibiting altogether the "excess interest" method that VALIC employed.[14]

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[13] See *National Securities*, 393 U.S. at 460; *FTC* v. *National Casualty Co.*, 357 U.S. 560 (1958); *VALIC I*, 359 U.S. at 77 n.8 (Brennan, J., concurring); Tex. Ins. Code Ann. §§ 21.20, 21.21, 21.21A (Vernon 1981 & 1987 Supp.); Ill. Rev. Stat. ch. 73, §§ 760, 761, 766, 1030, 1031 (1985). Because VALIC is a Texas insurance company, and because the class represented by respondent consists of Illinois participants in VALIC's fixed annuity program, we have used the Texas and Illinois insurance codes to illustrate the provisions of state law.

[14] See *VALIC I*, 359 U.S. at 77 (Brennan, J., concurring) ("[p]rescribed contract clauses are ordained legislatively or administratively"); Tex. Ins. Code Ann. § 3.45 (Vernon 1981 & 1987 Supp.); Ill. Rev. Stat. ch. 73, § 838 (1985). See also *id.* § 857.22:

> Any contract providing benefits payable in variable amounts delivered or issued for delivery in this State must contain a statement of the essential features of the procedures to be followed by the insurance company in determining the dollar amount of the variable benefits.

Likewise, states regulate and license the insurance agents who sell annuities,[15] and this too is a fundamental aspect of the regulation of the business of insurance.[16] However, if an annuity is a "security," a separate and wholly different set of federal rules on "broker/dealers" and NASD securities representatives would apply. These rules would require both the company and its agents to comply with numerous provisions that, *inter alia*, govern training and competence, set stringent net capital requirements, and impose mandatory recordkeeping.[17] Beyond doubt, these dual and overlapping regimes of regulation would impair or supersede the authority that Congress intended to leave to the states.

In addition, if an annuity is found to constitute a "security," the issuing company might not qualify for an exemption as an "insurance company" under the Investment Company Act and would be subject to the provisions of that statute.[18] In that event a multitude of federal requirements would become applicable. Some of these, such as limitations on "margin" purchases and "short" sales,[19] are designed to protect the financial stability of the company and therefore overlap the core purpose of state insurance regulation—to ensure the "[s]olvency and the adequacy of reserves" (*VALIC I*, 359 U.S. at 77 (Brennan, J., concurring)). Other requirements,

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[15] See, *e.g.*, Tex. Ins. Code Ann. §§ 21.01, 21.01-1, 21.02, 21.07-1 (Vernon 1981 & 1987 Supp.); Ill. Rev. Stat. ch. 73, §§ 1065.39-2 *et seq.* (1985).

[16] See *National Securities*, 393 U.S. at 460; *Robertson* v. *California*, 328 U.S. 440 (1946).

[17] See 15 U.S.C. §§ 78c(a)(4)-(5), 78o(a)(1), (a)(7), (c)(3); see also, *e.g.*, *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 570 (1979).

[18] See *VALIC I*, 359 U.S. at 67; *United Benefit*, 387 U.S. at 212; 15 U.S.C. §§ 80a-2(a)(17), 80a-3(a), (c)(3).

[19] See 15 U.S.C. § 80a-12(a).

such as those that govern the types of investments that the company may make,[20] would conflict with state supervision of an insurance company's investment portfolio.[21] And still other Investment Company Act restrictions, such as those prohibiting a company from distributing a "security" of which it is the issuer,[22] would require substantial changes in the manner in which the annuity is sold.

The Seventh Circuit's determination that VALIC's fixed annuity is a "security" and not insurance also could frustrate protections afforded policyholders under state insurance laws. In particular, 40 states—including Texas and Illinois—have established state insurance guaranty funds that ensure the payment of benefits and the continuation of coverage for insurance and annuity holders if the issuing company becomes insolvent.[23] However, these provisions are inapplicable to variable annuities or other contracts to the extent that they place the investment risk on the policyholder. Consequently, if a fixed annuity such as VALIC's is considered to be a "security," the decision below might render holders of "excess interest" annuities ineligible for coverage under state insurance guaranty programs, thus doing positive harm to the "beneficiaries" of the decision.

These and similar problems are especially acute in the area of fixed annuities. In contrast to the variable an-

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[20] See 15 U.S.C. §§ 80a-12(d), 80a-13(a)(2).

[21] See *VALIC I*, 359 U.S. at 77 & n.8 (Brennan, J., concurring); Tex. Ins. Code Ann. §§ 2.10, 3.39 (Vernon 1981 & 1987 Supp.); Ill. Rev. Stat. ch. 73, §§ 736 *et seq.* (1985).

[22] See 15 U.S.C. § 80a-12(b).

[23] See, *e.g.*, Tex. Ins. Code Ann. § 21.28-D (Vernon 1981); Ill. Rev. Stat. ch. 73, §§ 1065.80-1 *et seq.* (1985). In addition to Illinois, the other states within the Seventh Circuit also have insurance guaranty funds. See Ind. Code Ann. §§ 27-8-8-1 *et seq.* (West 1980 & 1987 Supp.); Wis. Stat. Ann. §§ 646.01 *et seq.* (West 1986 Supp.).

nuities at issue in *United Benefit*, which were maintained in a separate account that was segregated from the company's other proceeds (387 U.S. at 205),[24] fixed annuities are funded by the company's general assets, which also serve to fund its general insurance obligations (App., *infra*, 38a). Thus, the general assets behind the fixed annuities *are* the insurance company; federal requirements applicable to those annuities *do* regulate the business of insurance; and federal liabilities imposed against these assets *do* affect the company's reserves for meeting its commitments to its insurance holders—the heart of the state insurance system.

In sum, the exclusive state regulation of the business of insurance extends to "regulating the dealings between insurers and their policyholders," including "[t]heir negotiations * * * and the contract which resulted." *National Securities*, 393 U.S. at 459. VALIC's fixed annuities clearly had a substantial—indeed, a predominant—element of insurance. To superimpose federal securities requirements and liabilities on the state insurance structure applicable to these fixed annuities would interfere with that regulatory scheme and would intrude upon the authority of the states, contrary to the analysis of this Court in *Marine Bank* and *Daniel* and in violation of the declared policy of Congress in Section 3 (a) (8) and the McCarran-Ferguson Act.[25]

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[24] Similarly, in *VALIC I*, the company was engaged entirely in the issuance of variable annuities (see *VALIC I*, 359 U.S. at 74 n.3 (Brennan, J., concurring); *United Benefit*, 387 U.S. at 212), and therefore no traditional insurance operations were affected by the Court's decision.

[25] In these circumtances, the fact that the court of appeals' decision is technically interlocutory does not militate against this Court's review. The decision below conclusively holds that VALIC's fixed annuity was a "security"; it is that holding—not the remand for the determination of liability in this particular case—that presents a question of general public importance and immediate practical significance warranting further review. This Court has

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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OCTOBER 1987

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repeatedly granted certiorari to decide important issues under the federal securities laws, including the proper interpretation of the term "security," notwithstanding the technically interlocutory posture of the case. See, *e.g.*, *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983); *Marine Bank* v. *Weaver*, *supra*; *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *International Brotherhood of Teamsters* v. *Daniel*, *supra*; *Santa Fe Industries, Inc.* v. *Green*, *supra*; *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976); *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975).

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
SEVENTH CIRCUIT

Nos. 85-1816, 85-1919 and 85-2410

BEVERLY J. OTTO, individually, and on behalf of all others similarly situated,
Plaintiff-Appellant,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, *et al.*,
Defendants-Appellees.

Argued May 15, 1986

Decided Dec. 8, 1986

As Amended Dec. 10, 1986

Before BAUER, Chief Judge, and CUDAHY and RIPPLE, Circuit Judges.

CUDAHY, Circuit Judge.

The named plaintiff, Beverly J. Otto, brought this class action against Variable Annuity Life Insurance Company ("VALIC"), the Variable Annuity Marketing Company ("VAMCO"), a wholly-owned subsidiary of VALIC, certain other affiliated companies, and individual officers and directors of the corporate defendants. Otto alleged violations of the Securities Exchange Act of 1934 (the "1934 Securities Act"), 15 U.S.C.A. § 78a et seq. (West 1981 & Supp. 1986), the Employee Retirement Income

Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001-1461 (West 1985 & Supp. 1986), and the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C.A. §§ 1961-1968 (West 1984 & Supp. 1986). Otto also alleged conspiracy, breach of contract and common law fraud. The district court granted the defendants' motion for summary judgment on the Securities Act and ERISA claims, dismissed the RICO and conspiracy claims for failure to state a claim upon which relief could be granted, and dismissed the state law claims of breach of contract and common law fraud for lack of jurisdiction. 611 F.Supp. 83. The court refused to reconsider its order or permit Otto to file an amended complaint. 107 F.R.D. 635. We affirm the judgment of the district court, except that we reverse the judgment with respect to the dismissal of the claims of conspiracy to violate ERISA and the 1934 Securities Act and instead grant the defendants' motion for summary judgment on those claims.

I.

VALIC is in the business of selling, among other things, certain annuities which qualify for tax-exempt status under section 403(b) of the Internal Revenue Code. Typically, VALIC enters into a "group unit purchase contract" with a tax-exempt organization such as a public school or college under which the organization permits VALIC to offer its various annuity plans to the organization's employees. If an employee chooses to participate in one of VALIC's plans, he or she directs the employer to contribute a portion of the employee's salary (up to a statutorily prescribed maximum) to purchase an annuity.

VALIC offers participating employees two types of annuity contracts: the fixed annuity and the variable annuity. Under both plans, the principal and any return accumulate during the life of the contract. At the end of the contract, the employee may withdraw the accumu-

lated monies or use them to purchase an annuity from VALIC.

Under the fixed annuity, VALIC guarantees the principal and an interest rate of 4 percent per year for the first ten years and 3½ percent thereafter. "Excess" interest over the guaranteed rate is paid to fixed-annuity participants at the discretion of VALIC. Funds are held in VALIC's unsegregated general account and are invested primarily in long-term debt-type instruments such as mortgages and bonds.

Under the variable annuity, neither the principal nor the rate of return is guaranteed; both fluctuate with VALIC's investment performance. Funds are placed in what is known as a Separate Account, an account segregated from VALIC's general assets. The Separate Account's funds are invested in a diversified portfolio of common stocks and other equity-type investments.

Otto purchased a fixed annuity from VALIC in 1975. On August 2, 1982, she brought this class action on behalf of herself and all Illinois investors who participated in VALIC's fixed annuity plan between October 17, 1975 and August 2, 1982. Otto claims that VALIC failed to disclose the manner in which interest was calculated under the fixed annuity plan—specifically, that it used the "banding" or "new money" method for crediting "excess" interest to the fixed annuity account. Under the banding method, the current rate of excess interest is paid only on deposits made during the current period. All prior contributions continue to earn the rates of excess interest declared during the periods in which those contributions were made. Otto also claims that the defendants failed to disclose the method by which a participant in the fixed annuity plan could maximize his or her rate of return. According to Otto, an employee could earn the current rate of interest by transferring funds from the fixed account into a variable ac-

count for 120 days and then transferring them back into the fixed account. In Counts I, II and III of her amended complaint, Otto contends that the defendants' nondisclosure constitutes a violation of the 1934 Securities Act, a breach of their fiduciary duty under ERISA, and a violation of section 1962(c) of RICO. She alleges in Count IV that the defendants conspired to violate the 1934 Securities Act, ERISA and RICO. Counts V and VI allege breach of contract and common law fraud.

The defendants filed a motion to strike and dismiss Otto's amended complaint and for summary judgment. The district court granted summary judgment on the 1934 Securities Act and ERISA counts, finding these laws to be inapplicable because VALIC's fixed annuity did not constitute a security within the meaning of the federal securities laws or an employee benefit plan within the meaning of ERISA. The court dismissed the RICO count on the grounds that the complaint failed to specify an enterprise and each defendant's role in the alleged pattern of racketeering activity proscribed by that statute. The conspiracy count was dismissed for failure to allege any facts in support of such a claim. With the dismissal of these federal claims which had furnished the basis of pendent jurisdiction, the court dismissed the contract and common law fraud claims.[1]

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[1] Otto asserted in her brief and at oral argument that the district court improperly dismissed the state law claims with prejudice, thereby barring her from pursuing the claims in state court. We believe that Otto has misread the district court's opinion. The district court dismissed the state law claims on the ground that its disposition of the federal claims eliminated any basis for pendent jurisdiction. The court's citation of *United Mineworkers v. Gibbs*, 383 U.S. 715, 725-26, 86 S.Ct. 1130, 1138-39, 16 L.Ed.2d 218 (1966), for support makes clear that the dismissal was without prejudice. Otto is free to pursue her claims of breach of contract and common law fraud in state court.

II.

Section 3(a)(8) of the Securities Act of 1933 exempts from its provisions "[a]ny insurance or endowment policy or annuity contract or optional annuity contract" issued by a corporation subject to supervision by the appropriate insurance regulatory authority. 15 U.S.C. § 77c(a)(8) (1982). The issue before us is whether the fixed annuity plan sold by VALIC is an "annuity" under section 3(a)(8) or whether the plan is an "investment contract" subject to the requirements of the 1934 Securities Act. The district court held that VALIC's fixed annuity was more properly viewed as an insurance product than as an investment contract. Because we agree with the district court's determination that the annuity in question falls within the section 3(a)(8) exemption, we hold that the district court properly granted summary judgment on the 1934 Securities Act claim.

In *S.E.C. v. Variable Annuity Life Insurance Co.* (*"VALIC"*), 359 U.S. 65, 79 S.Ct. 618, 3 L.Ed.2d 640 (1959), the Supreme Court considered whether a variable annuity was a security or insurance. The Court discussed the characteristics distinguishing the variable annuity from the traditional fixed annuity. Generally, the funds underlying the fixed annuity are invested according to conservative standards, and the fixed annuity pays a specified and definite amount to the annuitant. In contrast, the variable annuity's funds are invested primarily in common stocks and other equities, and the variable annuity's benefits vary with the success of the company's investment experience. The holder of a variable annuity, therefore, is not able to depend upon the annuity's paying a fixed return. *Id.* at 69-70, 79 S.Ct. at 620-21. The insurance company in *VALIC* stressed the fact that, as with all insurance, the company assumed the mortality risks under both the variable and the fixed annuity plans. Yet the Court found this characteristic alone an insufficient basis for considering a

variable annuity to be insurance. Insurance, according to the Court, "involves some investment risk-taking on the part of the company" and "a guarantee that at least some fraction of the benefits will be payable in fixed amounts." *Id.* at 71, 79 S.Ct. at 622. An annuity contract that did not guarantee a fixed return thus places all of the investment risk on the policyholder and none on the company. Because there was "no true underwriting of risks," *id.* at 73, 79 S.Ct. at 623, the *VALIC* Court concluded that the variable annuity was a security.

In *S.E.C. v. United Benefit Life Insurance Co.*, 387 U.S. 202, 87 S.Ct. 1557, 18 L.Ed.2d 673 (1967), the Court again explored the distinction between a security and insurance in considering a deferred, or optional, annuity plan. Under this "Flexible Fund" annuity program, the purchaser's premiums less a deduction for expenses (the net premium), and any money earned from investing the premiums, were held in a Flexible Fund Account, which United maintained separately from its other funds. The purchaser was entitled to withdraw the "cash value" of the policy before maturity. The "cash value" was equal to the higher of two amounts: the purchaser's proportional share of the fund or the "net premium guarantee," which was measured by a gradually increasing percentage of the purchaser's net premiums, from fifty percent of net premiums in the first year to one hundred percent after ten years. At maturity, the purchaser had the option of either receiving the cash value of the policy or converting that interest into a life annuity. Although the dollar amount of the fixed payments under the life annuity varied with the cash value of the policy, the net premium guarantee ensured that a minimum annuity would be available at maturity. *Id.* at 205-06, 87 S.Ct. at 1558-59.

The Court assessed the Flexible Fund portion of the contract independently from the annunity portion of the contract and concluded that the Flexible Fund contract

did not fall within the insurance exemption of the federal securities laws. The test to determine whether an instrument is an investment contract, according to the Court, "is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." *Id.* at 211, 87 S.Ct. at 1562 (quoting *S.E.C. v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 352-53, 64 S.Ct. 120, 124, 88 L.Ed.2d 88 (1943)). The Court noted that the Flexible Fund completely reversed the role of the insurer during the accumulation period. Instead of offering the inducements typical for insurance, such as "stability" and "security," United proposed to serve as an investment agency and promised the policyholder "growth." *Id.* at 211, 87 S.Ct. at 1562. At maturity, the insurer was obligated to produce only the guaranteed minimum, an amount "substantially less than that guaranteed by the same premiums in a conventional deferred annuity contract." *Id.* at 208, 87 S.Ct. at 1560. Although the minimum guarantee "substantially" reduced the investment risk of the purchaser, the Court pointed out that there was a "basic difference between a contract which to some degree is insured and a contract of insurance." *Id.* at 211, 87 S.Ct. at 1562. The Court found the minimum guaranteed in *United Benefit* to be so low that the risk to the insurance company was insignificant.

This court considered whether a "group deposit administration annuity contract" constituted a security or insurance in *Peoria Union Stock Yards Co. v. Penn Mutual Life Insurance Co.*, 698 F.2d 320 (7th Cir. 1983). Under the contract at issue in *Peoria Union*, the employer contributed annually to a deposit account at Penn Mutual to fund a defined-benefit retirement plan for its employees. When an employee retired, the employer could purchase the annuity from the insurance company with a portion of the funds on deposit or it could withdraw funds and purchase the annuity for its employee from

another insurance company. *Id.* at 321. The income available to fund the employer's obligations to its employees for the fixed benefit annuity fluctuated with the investment experience of Penn Mutual. Penn Mutual guaranteed interest on the employer's contributions made during the first three years of the contract at a rate declining from 7½ percent the first year to 3½ percent the third year. Although there was no guarantee of interest after the first three years, any interest earned by the deposit account beyond the interest guarantee was required to be credited to the deposit account. *Id.* at 322. It is unclear from the opinion whether or not the funds for these contracts were held by Penn Mutual in a separate account segregated from its general assets.

This court observed that the contract in *Peoria Union* was similar to the deferred annuity contract in *United Benefit* in that the insurance company actually served as an investment agency and permitted the pension plan to share in the company's investment experience. *Id.* at 325. Moreover, in both cases, the insurance company guaranteed a minimum return so low as to place the investment risk on the investor rather than on the insurance company. *Id.* Based on these characteristics of the plan, the court concluded that during the accumulation phase the annuity plan was an investment contract.

Unlike the plans evaluated in *Peoria Union*, *United Benefit*, and *VALIC*, the defendant VALIC's fixed annuity plan in the present case appealed to potential participants on the usual insurance bases of stability and security. VALIC promoted the fixed annuity as a long-term accumulation of funds for retirement through compound interest. Contributions were mingled with the company's general assets and invested primarily in debt-type securities. Regardless of the investment success of VALIC's general account, VALIC was required to pay a guaranteed rate of interest on all fixed annuity contributions of 4 percent during the first ten years and 3½

percent thereafter. Although this was a low rate of return, it was not so low that we can say it placed the investment risk on the policyholder in a way substantial enough to make the fixed annuity a security. VALIC advertised that, although the earning power of the participant in the fixed plan might not be as great as anticipated due to inflation, the participant had the peace of mind that the investment was guaranteed regardless of economic conditions. Although VALIC boasted that the company's funds were managed by experienced and trained investment managers, as we stated in *Peoria Union*, investment management is the "life blood" of life insurance companies, *Peoria Union*, 698 F.2d at 322, and thus it was not inappropriate for VALIC to tout its investment experience even in relation to an insurance product. The difference between the plan before us and the one considered in *Peoria Union* is not enormous, but the balance of the investment risk has been sufficiently shifted to the insurance company to justify a different result here.

In addition, that VALIC promoted its fixed annuity as insurance is especially apparent when contrasted with its promotion of its variable annuity. VALIC advertised its variable annuity as having a principal objective of long-term capital growth of tax-deferred investments. The contributions of all participants in the variable annuity were held together in a Separate Account, segregated from VALIC's other investments. This Separate Account was invested in common stocks and other equity-type investments. The value of the variable annuity varied with the investment results of the stocks held in the portfolio. VALIC emphasized in its literature that a significant difference between the fixed and the variable annuity was that VALIC assumed the investment risk for the fixed annuity to the extent of guaranteeing minimum fixed rates of compound interest and providing for excess interest credits. The fixed annuity, however, was not intended as a hedge against inflation or the depreciation of the dollar.

Such protection was purportedly afforded by the variable annuity plan for participants willing to accept investment risks.

Our view that VALIC's fixed annuity does not constitute a security is supported by the Securities and Exchange Commission's recent issuance of Rule 151, which establishes a "safe harbor" for certain types of annuity contracts by guaranteeing them exemption from the federal securities laws. 51 Fed.Reg. 20,262 (1986). If a contract complies with the requirements of Rule 151, it is deemed to be an "annuity contract or optional annuity contract" under section 3(a)(8) of the 1933 Securities Act and thus exempt from the provisions of the federal securities laws.[2] Although Rule 151 is not applicable in this case because its effective date is subsequent to the sale in question, an examination of the Rule is nevertheless helpful in determining the scope of the section 3(a)(8) exclusion.

Rule 151 provides:

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[2] In the Securities and Exchange Commission's discussion accompanying the enactment of Rule 151, the SEC emphasized that the Rule does not attempt to cover all annuity contracts that are exempt from the provisions of the Securities Act:

> Rule 151 is merely a "safe harbor," not an all-inclusive definition purporting to encompass every annuity contract that falls within the section 3(a)(8) exclusion. . . . [T]he rule simply defines a class of annuities that the Commission believes is clearly entitled to rely on the section. While compliance with rule 151 will assure "non-security status," failure to comply with the rule would not mandate "security status" for an annuity product. . . . [A]n insurer offering a contract that . . . does not satisfy all of the rule's conditions may still rely directly on section 3(a)(8), albeit with no Commission assurance that the contract is covered by the section 3(a)(8) exclusion.

Definition of Annuity Contract, Discussion Accompanying Enactment of Rule 151, Securities Act Release No. 6645, Fed.Sec.L.Rep. (CCH) ¶ 84,004, at 88,129 (May 29, 1986).

(a) Any annuity contract or optional annuity contract (a "contract") shall be deemed to be within the provisions of section 3(a)(8) of the Securities Act of 1933 [15 U.S.C. 77c(a)(8)], *Provided*, That

(1) The annuity or optional annuity contract is issued by a corporation (the "insurer") subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;

(2) The insurer assumes the investment risk under the contract as prescribed in paragraph (b) of this section; and

(3) The contract is not marketed primarily as an investment.

(b) The insurer shall be deemed to assume the investment risk under the contract if:

(1) The value of the contract does not vary according to the investment experience of a separate account;

(2) The insurer for the life of the contract

(i) Guarantees the principal amount of purchase payments and interest credited thereto, less any deduction (without regard to its timing) for sales, administrative or other expenses or charges; and

(ii) Credits a specified rate of interest (as defined in paragraph (c) of this section) to net purchase payments and interest credited thereto; and

(3) The insurer guarantees that the rate of any interest to be credited in excess of that described in paragraph (b)(2)(ii) of this section will not be modified more frequently than once per year.

> (c) The term "specified rate of interest," as used in paragraph (b) (2) (ii) of this section, means a rate of interest under the contract that is at least equal to the minimum rate required to be credited by the relevant nonforfeiture law in the jurisdiction in which the contract is issued. If that jurisdiction does not have any applicable nonforfeiture law at the time the contract is issued (or if the minimum rate applicable to an existing contract is no longer mandated in that jurisdiction), the specified rate under the contract must at least be equal to the minimum rate then required for individual annuity contracts by the NAIC Standard Nonforfeiture Law.

51 Fed.Reg. 20,262 (1986).

VALIC's fixed annuity satisfies all of the requirements of Rule 151. VALIC, the insurer, is subject to the insurance laws of Texas and to regulation by the Texas Commissioner of Insurance, as well as to the insurance laws and regulations of all states in which it is licensed to do business, thereby satisfying the first prong, subsection (a) (1), of Rule 151. VALIC's fixed annuity also fulfills the requirement under the second prong, subsection (a) (2), that the insurer assume the investment risk. Contributions are not invested in a separate account and therefore the value of the contract is not tied to the investment experience of such an account. *See* Rule 151 (b) (1). VALIC guarantees that a participant will receive the cash value of all premiums and a specified rate of interest of 4 percent for the first ten years and 3½ percent thereafter. These specified rates of interest are more than the 3 percent minimum rate required under the Rule.[3] *See* Rule 151 (b) (2) (ii). Under subsection

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[3] Illinois has not established a minimum rate of interest for individual annuities under its non-forfeiture statute. Accordingly, we rely on the minimum rate required to be paid for individual annuity contracts under the National Association of Insurance Companies Standard Nonforfeitire Law.

(b) (3), the insurer must guarantee that its rate of excess interest will not be modified more than once per year. Although VALIC does not guarantee that it will leave the excess interest rate unchanged for a year, it does use the "banding" method of computing interest. Under this method, VALIC in effect guarantees the excess interest rate on every deposit for the life of the annuity contract. In its discussion of Rule 151 that was released with the rule's enactment, the SEC made clear that it considered the banding method, or in the SEC's words, the "payment basis" of computing interest, as satisfying this second requirement of Rule 151.[4] Finally, the Rule requires under its third prong, subsection (a) (3), that the contract not be marketed primarily as an investment. Although the award of discretionary excess interest and VALIC's investment experience were given some emphasis, the fixed annuity, as discussed above, was marketed *primarily* on the basis of its stability and security.

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[4] The Commission noted that when it offered the proposed Rule 151 for public comment, several commentators asked how the one-year requirement would be applied to annuities that computed excess interest according to alternative methods such as the banding method used here. The Commission responded as follows:

> In this regard, one commentator observed that excess rates may be established on a contract basis, pursuant to which rates are declared for all funds under the contract, or they may be determined on a payment basis, where specified rates are established for all payments received in a particular time period (day, month, quarter, etc.).
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> * * * *
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> . . . [The Commission does not] wish to prevent insurers from establishing rates on a contract basis or a per payment basis, as described above.

Definition of Annuity Contract, Discussion Accompanying Enactment of Rule 151, Securities Act Release No. 6645, Fed.Sec.L.Rep. (CCH) ¶ 84,004, at 88,134-35 (May 29, 1986).

III.

Otto argues that the district court erroneously granted summary judgment for the defendants on her ERISA count. The district court found that the annuity plan was not maintained or established by Otto's employer and thus was not subject to the provisions of ERISA. Under ERISA, "the terms 'employee pension benefit plan' and 'pension plan' mean any plan, fund, or program which was heretofore or is hereafter *established or maintained by an employer* or by an employee organization, or by both. . . ." 29 U.S.C. § 1002(2)(A) (1982) (Emphasis added). Otto's employer's sole involvement with the annuity plan was to permit VALIC, along with various other companies, to present benefit plans to its employees and, if a VALIC plan was chosen by the employee, to collect the contributions for the plan from the employee and remit them to VALIC. Otto herself emphasized in the district court that the plans sold by VALIC were not established or maintained by a school district or any other governmental agency; rather, the VALIC contracts were "established and maintained only by VALIC." Record, Document 142 (hereinafter R. 142) at 4.[5] Otto nevertheless maintained that the VALIC plan was covered by ERISA because the employer "entered into what

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[5] As Otto admitted in her reply to the defendants' motion to dismiss and for summary judgment:

> It must be emphasized that after the enabling agreement is signed and an employee signs up, nothing but the ministerial duty of withholding the amount designated by the employee and sending it to the company remains for the school district to perform. The school district cannot manage funds, make investment decisions, determine claims, determine benefits, determine costs, change terms, or do anything about the contract. All it can do is withhold money pursuant to the employee's authorization and send it to the annuity company. Thus, these investment annuity contracts are not contracts *maintained* by the school district. R. 131, at 32 (emphasis in original).

may be called an enabling contract with VALIC whereby VALIC may provide investment annuities to the employers." R. 131, at 31-32.

The Department of Labor has promulgated a regulation defining the phrase "established and maintained by an employer" as that phrase is used in ERISA. Under 29 C.F.R. § 2510.3-2(f) (1985), a program for the purchase of an annuity or the establishment of a custodial account shall not be deemed to be established or maintained by an employer within the meaning of ERISA when (among other factors not relevant here) the sole involvement of the employer is to permit annuity contractors to offer their products to employees and collect and remit payment and maintain records of such payments. The construction by the Department of Labor, which is entrusted with the enforcement of ERISA, is entitled to considerable weight. *Abella v. W.A. Foote Memorial Hospital*, 740 F.2d 4, 5 (6th Cir. 1984). *See also Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 164, 89 L.Ed. 124 (1944). We therefore agree with the district court's finding that in the named plaintiff's case the "minimal, ministerial activities [performed by plaintiff's employer] do not render VALIC's fixed annuity plan one 'established or maintained' by the school district." 611 F.Supp. 83, 88 (N.D.Ill. 1985).

Otto argues that the Secretary of the Department of Labor exceeded his authority in enacting this regulation. Under 29 U.S.C. § 1135 (1982), the Secretary may "prescribe such regulations as he finds necessary or appropriate to carry out the provisions of [ERISA]." Thus, the Secretary did not exceed his authority in promulgating Section 2510.3-2(f) defining the phrase "established or maintained by an employer" as used in ERISA.[6]

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[6] Otto also relies on 26 U.S.C. § 403(b), which provides tax-exempt status to an "annuity contract [that was] . . . purchased by an employer." She contends that it is inconsistent for the

Otto argues on appeal, however, that the district court erroneously based its decision to grant summary judgment on the ERISA claim against the entire plaintiff class solely on the facts that applied to the named plaintiff and ignored whatever facts existed concerning the other class members. On appeal, Otto suggests for the first time that the description of the plan set forth by her and relied on by the district court in granting summary judgment "may be unique to Otto." Appellant's Brief at 30. Yet Otto has never before argued that the administration of VALIC's fixed annuity plan differs among employers in any way that would render the plan "established or maintained by an employer." Throughout her pleadings in the court below, and even in her brief submitted to this court, she has described the role played by the employer pursuant to the plan as being the same across employers.[7] Otto may not offer on appeal

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annuity to be deemed to be purchased by an employer for purposes of section 403(b) but not deemed to be maintained or established by an employer for purposes of ERISA. This argument is meritless.

[7] In her brief, Otto emphasizes that "the mechanics of these programs are important for purposes of this litigation." Appellant's Brief at 4. She describes the plan as follows:

> In the usual situation—and this is true in the case of the named plaintiff Otto—an employer is contacted by a number of companies to make available their respective plans to the employer's employees. . . .
>
> The master contract merely empowers the employer to collect the contribution from the employee and pay it over to the company. . . . The employer has no rights of any kind as to investments, pay-outs, records or anything else relating to the investment contract. All matters rest with VALIC and VAMCO the companies selling the contract. The employer abdicates all responsibility of any kind for the plan, except for the sole act of collecting funds and turning them over to the company. . . .

Id. at 4.

arguments against summary judgment that were not raised before the trial court.[8]

IV.

Otto claims that the district court erred in dismissing the RICO count. To allege a violation under section 1962 (c) of RICO, a plaintiff must allege that the defendant "(1) was employed by or associated with (2) an enterprise engaged in, or the activities of which affected, interstate or foreign commerce, and (3) that the person conducted or participated in the conduct of the enterprise's affairs (4) through a pattern of racketeering activity." *Haroco, Inc. v. American National Bank & Trust Co.*, 747 F.2d 384, 387 (7th Cir. 1984), *aff'd*, 473 U.S. 606, 105 S.Ct. 3291, 87 L.Ed.2d 437 (1985). The district court dismissed the RICO count because it failed to identify the enterprise and each defendant's role in the pattern of racketeering activity.

We affirm the dismissal of the RICO count for failure to identify the enterprise. Otto concedes that she did not

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[8] As this court has stated, "[i]t is a well-settled rule that a party opposing a summary judgment motion must inform the trial judge of the reasons, legal or factual, why summary judgment should not be entered. If it does not do so, and loses the motion, it cannot raise such reasons on appeal." *Liberles v. County of Cook*, 709 F.2d 1122, 1126 (7th Cir. 1983).

Further, even if Otto was permitted to raise this argument, her vague suggestion that the facts she has repeatedly recited "may be unique to Otto," Appellant's Brief at 30, may be insufficient to rebut the defendants' strong showing that there exists no genuine dispute as to any material fact relating to the ERISA claim. A plaintiff is required to respond to a defendant's motion with "specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. 56(e). "Thus, the mere possibility that a factual dispute *may* exist, without more, is not sufficient to overcome a convincing presentation by a moving party." *Quinn v. Syracuse Model Neighborhood Corp.*, 613 F.2d 438, 445 (2d Cir. 1980) (emphasis in original); *see also Celotex Corp. v. Catrett*, —— U.S. ——, 106 S.Ct. 2548, 2553, 91 L.Ed.2d 265 (1986).

identify the enterprise but argues that she was not required to do so because it was "obvious" that VAMCO was the enterprise.[9] Yet in responding in the district court to the defendants' motion to dismiss for failure to identify the enterprise, Otto suggested that the enterprise here could be "a structural business entity such as VALIC itself, VAMCO, or a board of directors such as the individual defendants, [or] . . . associations in fact, though not a legal entity." R. 131, at 37. Otto's own words reveal that the enterprise was far from "obvious" in her amended complaint.

We therefore do not have to reach the district court's finding that Otto failed to plead with the specificity required by Federal Rule of Civil Procedure 9(b) each defendant's involvement in the fraudulent activity. We note, however, that our finding in *Haroco* that the civil RICO claim made there met the specificity requirements of Rule 9(b) also apparently describes Otto's RICO claim in the present case:

> [T]he complaint adequately specified the transactions, the content of the allegedly false representations, and the identities of those involved. In addition, the identification of the transactions and the description of the alleged scheme to defraud put defendants on fair notice of the time and place of the alleged false representations.

747 F.2d at 405.

V.

Otto claims that all of the defendants conspired to violate RICO, ERISA and the 1934 Securities Act. The district court dismissed the conspiracy count for failure

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[9] "Even though no specific 'enterprise' was named in the Amended Complaint, the status of VAMCO, which made the fraudulent mailing as an agent for its parent VALIC, is obvious." Appellant's Brief at 37.

to state a claim but did not rule on the defendants' motion for summary judgment on the conspiracy claim. We affirm the dismissal of the claim alleging conspiracy to violate RICO. We reverse, however, the dismissal of the claims of conspiracy to violate ERISA and the 1934 Securities Act and find that the district court instead should have granted the defendants' motion for summary judgment on those claims.

To state a claim for conspiracy, a plaintiff must allege the agreement of each defendant to the operation of the conspiracy. *See United States v. Neapolitan*, 791 F.2d 489, 496 (7th Cir. 1986); *Thornton v. Evans*, 692 F.2d 1064 (7th Cir. 1982). A complaint may be dismissed if it contains only conclusory, vague and general allegations of conspiracy. *Fullman v. Graddick*, 739 F.2d 553, 557 (11th Cir. 1984). In dismissing the conspiracy count, the district court stated that "[t]here are simply no facts alleged which permit a reasonable inference that the dozens of defendants, many of whom were no longer affiliated with VALIC when other defendants *began* their association with the company, ever assented to a conspiracy to violate various federal laws." 611 F.Supp. at 90 (N.D.Ill. 1985) (emphasis in original). We disagree with this characterization of Otto's complaint. In her complaint, Otto alleged that each of the defendants agreed and conspired to violate RICO, ERISA and the 1934 Securities Act; she identified each defendant's specific position with the corporation at the time of the alleged conspiracy; and she alleged several overt acts committed by the defendants in furtherance of the conspiracy. We believe that Otto has stated a claim for conspiracy to violate ERISA and the 1934 Securities Act.

However, Otto's claim for conspiracy to violate RICO fails for the same reason her RICO claim failed, that is, she did not identify a RICO enterprise. This circuit has stated that it is the existence of an enterprise that distinguishes a RICO conspiracy from other conspiracies.

Neapolitan, 791 F.2d at 499-50.[10] A RICO conspiracy claim cannot stand absent an allegation of the involvement of an enteprise. We therefore affirm the dismissal of Otto's claim of conspiracy to violate RICO.

After dismissing the defendants' conspiracy count, the district court did not reach their motion for summary judgment on this count. In light of our affirmance of the district court's grant of summary judgment on the 1934 Securities Act and ERISA claims, the defendants clearly were also entitled to summary judgment on the claim of conspiracy to violate those statutes. Otto bases her conspiracy claim almost entirely on her allegations of violations of the underlying statutes. Because we have held those statutes inapplicable to VALIC's fixed annuity plan, there exists no genuine dispute as to whether the defendants conspired to violate them through the promotion of the plan.

A remaining question is whether this court should itself grant the defendants' motion for summary judgment or remand this issue to the district court. The parties have had a full and fair opportunity to argue all relevant aspects of the summary judgment issue, both pursuant to the defendant's summary judgment motion in the district court and in connection with the 1934 Securities Act and ERISA claims before this court. The correct resolution of this issue is clear. Because there is nothing to be gained from a remand, and in the interest of judicial economy, we hold that the defendants are en-

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[10] "[A] distinctive aspect of a RICO conspiracy is the need to establish the existence of an enterprise." 791 F.2d at 499. "[C]onsent to the commission of two criminal acts standing alone does not constitute a RICO conspiracy. The defendant must also agree to 'conduct or participate in the affairs of the enterprise.' Both these elements must be present and together they establish a conspiracy the objective of which is a violation of RICO." *Id.* at 499 n. 5.

titled to summary judgment on Otto's claim of conspiracy to violate ERISA and the 1934 Securities Act.[11]

VI.

In response to the defendants' motion for summary judgment, Otto filed a motion pursuant to Federal Rule of Civil Procedure 56(f) asking for a continuance of the hearing on the defendants' motion and for an opportunity to conduct further discovery. The magistrate, in an opinion adopted by the district court, denied this motion. Otto argues that the district court abused its discretion in denying her motion.[12]

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[11] Appellate courts in analogous situations have chosen to decide, rather than remand, issues where the issue was simple, its resolution was clear, and the parties had been afforded a full opportunity to be heard. *See, e.g., Richmond Leasing Co. v. Capital Bank*, 762 F.2d 1303, 1313 (5th Cir. 1985) ("Remand is unnecessary . . . if 'all the facts relied upon to support the judgment are in the record and are undisputed, or if the record as a whole presents no genuine issue as to any material fact.'") (quoting *King v. Commissioner of Internal Revenue*, 458 F.2d 245, 249 (6th Cir. 1972); *Shaw v. F.B.I.*, 749 F.2d 58, 63 (D.C.Cir. 1984)) ("Since there are no disputed facts, it would be futile to remand the issue to the District Court and we proceed to its resolution."); *In re Hronek*, 563 F.2d 296, 298 (6th Cir. 1977) ("Although we recognize that the normal procedure is to remand a case where the lower court has not considered a pertinent issue, considerations such as judicial economy dictate otherwise where the correct resolution of the issue is clear."); *Smith v. Government of Virgin Islands*, 329 F.2d 135, 142 (3d Cir. 1964) ("Since the record made below fairly presents the issue as to whether [defendants] are entitled to summary judgments judicial economy will patently be served by an immediate determination of this issue rather than remanding these cases to the District Court for disposition.").

[12] Otto also argues that the magistrate construed the defendants' motion as one requesting only dismissal under Rule 12(b)(6). The magistrate did not mischaracterize the defendants' motion. At the outset of her opinion, the magistrate acknowledged that the defendants' motion sought either dismissal or summary judgment.

Summary judgment is proper if the pleadings, depositions, answers to interrogatories and admissions on file, together with any affidavits, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). Thus, if, after adequate time for discovery and upon motion, a party fails to make a showing of a genuine issue of material fact, summary judgment is appropriate. *Celotex Corp. v. Catrett*, —— U.S. ——, 106 S.Ct. 2548, 2553, 91 L.Ed.2d 265 (1986). Rule 56(f) permits a party who has no specific evidence contradicting an opponent's motion for summary judgment to survive the motion by both presenting valid reasons for the lack of proof and showing how postponement of a ruling will enable the non-movant to rebut the movant's showing. *Gieringer v. Silverman*, 731 F.2d 1272, 1280 (7th Cir. 1984); *Korf* v. *Ball State University*, 726 F.2d 1222, 1230 (7th Cir. 1984). A district court's ruling on a Rule 56(f) motion may be reversed only for an abuse of discretion. *See Korf*, 726 F.2d at 1231.

The magistrate denied additional discovery because plaintiff's Rule 56(f) motion failed to demonstrate a need for further discovery. The defendants' motion for summary judgment was based upon admissions of the plaintiff, documents she had attached to her complaint, and the affidavits of two VALIC employees. The affidavits of the VALIC employees vouched for facts which Otto either already knew or about which she could readily determine whether a dispute existed. Otto did not adequately explain why she was unable to respond to defendants' motion. She merely made the general assertion that she needed an opportunity for additional discovery to respond to the allegations. Otto claimed that discovery had been deferred until after the class had been certified. Any deferral of discovery, however, was due to plaintiff's lack of diligence rather than to a court order. Moreover, Otto failed to indicate how production

of the documents she sought would have assisted her in resisting summary judgment. The district court's refusal to grant a continuance for additional discovery was not an abuse of discretion.

VII.

Otto argues that the court erred in denying her post-trial motions requesting leave to file a second amended complaint. On April 19, 1985, Otto filed a motion to reconsider and for leave to file a second amended complaint. On April 26, 1985, the court denied Otto's request because she failed to attach a second amended complaint to her motion or inform the court how she planned to cure the deficiencies of the first amended complaint. Otto filed a second motion to reconsider and for leave to amend on May 10, 1985. Although she submitted a second amended complaint with her second motion to reconsider, the court found that Otto's motion to reconsider was untimely and that amendment would be futile.

Following an entry of judgment on the dismissal of a complaint by a district court, a plaintiff may amend the complaint under Federal Rule of Civil Procedure 15(a) only after the judgment has been set aside or vacated pursuant to a motion under Rule 59(e) or Rule 60(b) and leave of court to amend has been granted. *Twohy v. First National Bank*, 758 F.2d 1185, 1196 (7th Cir. 1985); *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1111-12 (7th Cir. 1984), *cert. denied*, 470 U.S. 1054, 105 S.Ct. 1758, 84 L.Ed.2d 821 (1985). Although leave to amend shall be freely given when justice so requires, Fed.R.Civ.P. 15(a), the decision to allow amendment after dismissal lies within the sound discretion of the trial court. A motion to amend should state with particularity the grounds for the motion and should be accompanied by the proposed amendment. 3 J. Moore, Moore's Federal Practice ¶ 15.12, at 15-115 (2d ed. 1984). Failure to tender an amended complaint with a Rule 59(e) motion may indicate a lack of dili-

gence and good faith. *Twohy*, 758 F.2d at 1197; *see also Verhein v. South Bend Lathe, Inc.*, 598 F.2d 1061, 1063 (7th Cir. 1979) (per curiam) (court may properly refuse request to amend where moving party has not shown proposed amendment has substantial merit).

Otto failed to tender a second amended complaint with her first Rule 59(e) motion. She also failed to explain why a second amended complaint was not filed with the motion. She did not indicate how she planned to cure the deficiencies that resulted in the dismissal of the amended complaint. Rather, she merely stated that she would respond to the defendants' first motions attacking the complaint. Under these circumstances, we cannot say that the trial judge abused his discretion in denying Otto's motion to amend.

The district court construed Otto's second motion to reconsider and for leave to amend as another Rule 59(e) motion and denied the motion as untimely. A motion under Rule 59(e) must be brought within ten days after the entry of judgment. Otto filed her second motion to reconsider twenty-nine days after the court's dismissal of the action and fourteen days after its denial of her first motion to reconsider. Thus, to the extent that the motion may be construed as one brought under Rule 59(e), the district court was correct in denying the motion as untimely.

Otto, on appeal, states that the second motion to reconsider was brought under Rule 60(b), which allows relief from judgment for, among other things, mistake, inadvertence, excusable neglect, newly discovered evidence and fraud.[13] She, however, does not point to a specific permissible reason under 60(b) which applies to this

[13] Motions pursuant to Rule 60(b) must be made "within a reasonable time" and in some instances within one year of the judgment. If Otto's motion was properly brought under Rule 60(b), it was not untimely.

case. In her second motion to reconsider, Otto explained why a second amended complaint had not accompanied her first motion to reconsider and how the attached second amended complaint corrected the deficiencies of the first amended complaint. In addition, she argued the merits of the court's order dismissing the action. We agree with the district court that Otto's request was for the court to amend its judgment by correcting errors of law under Rule 59(e) rather than for relief from judgment for any reason allowed under Rule 60(b). Accordingly, the district court's refusal to reopen the judgment was not an abuse of discretion. Because Otto was not successful in reopening the judgment, her motion for leave to amend was a nullity and the decision of the district court denying leave to amend was correct. *See Car Carriers*, 745 F.2d at 1112.

AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
SEVENTH CIRCUIT

Nos. 85-1816, 85-1919 and 85-2410

BEVERLY J. OTTO, individually, and on behalf of all others similarly situated,
Plaintiff-Appellant,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, *et al.*,
Defendants-Appellees.

Opinion on Rehearing April 15, 1987

OPINION ON REHEARING

CUDAHY, Circuit Judge.

Following the issuance of our opinion in this case, the defendant, Variable Annuity Life Isurance Company ("VALIC"), filed a motion to modify the opinion, and the plaintiff, Otto, filed a petition for rehearing. In its motion to modify the opinion, VALIC for the first time informed this court that it claimed to have the right to alter, at its unfettered discretion, the interest "bands" paid on past contributions. Earlier, both before the district court and this court, VALIC had claimed only that it had the discretion to declare the excess interest rate to be paid on new deposits. VALIC emphasized that

these discretionary changes in the excess interest rate affected only current deposits and that past deposits would continue to earn the interest rate in effect at the time the deposit was made:

> Like virtually all of its competitors at that time, VALIC employed the "new money" or "banding" method for crediting excess interest to the fixed annuity account; *i.e.*, the excess interest rate set by the Board of Directors was paid on deposits made during that particular period. Subsequent fluctuations in the excess rate did not affect a participant's past contributions. Each deposit stayed in its "band," and continued to draw interest at the rate in effect when the deposit was made.

Defendants' Brief at 4-5 (footnote omitted). VALIC made similar representations in its literature soliciting participants for its fixed annuity plan. A formal written proposal, which VALIC said was sent to "virtually all, if not all, prospective customers" in the Midwest Region during the years 1979 to 1983, contained the following question and answer:

> Describe the basis for the dividends or current interest rate illustrated above. The current rate of interest is composed of the guaranteed interest rate plus "excess interest." Excess interest is declared and guaranteed for deposits received in the Fixed Account on a calendar quarter basis by the Board of Directors of VALIC. Excess interest is computed daily and credited on amounts remaining in a participant's Fixed Account at the end of each calendar quarter.
>
> VALIC employs the new money method for crediting excess interest. The current interest rate is paid on monies for the period in which it is in effect. *Should the current interest rate change (i.e., up or down), it would not affect a participant's past contributions but only those contributions deposited*

> *while the new rate is in effect.* A change in the current rate would in no way affect the past accumulations in a participant's account balance.

Defendants' Memorandum in Opposition to Plaintiff's Motion for Class Certification, Exhibit C (emphasis added). Based on repeated statements such as this made by VALIC coupled with VALIC's failure to assert the right to alter past bands, this court concluded that the interest bands were guaranteed for the life of the contract.

We will accept solely for the purposes of this rehearing VALIC's assertion that it had the right to change at any time the interest bands paid on past deposits. The question then becomes what effect does this new fact have on our determination that the fixed annuity was an insurance product rather than a security and therefore not subject to federal securities laws. Not surprisingly, VALIC argues that the soundness of our prior determination is unaffected. VALIC suggests that we merely delete from our opinion the following sentence: "Under this method, VALIC in effect guarantees the excess interest rate on every deposit for the life of the annuity contract." *Supra*, at 1134. Otto, on the other hand, argues that the correctness of that sentence is crucial to the opinion's determination that the fixed annuity is not a security but an insurance product. Otto requests, both in its response to VALIC's motion and in its petition for rehearing, that we withdraw our entire discussion of this issue and find instead that the fixed annuity is a security. We agree with Otto that we cannot simply delete the sentence and leave the remainder of the discussion untouched. We therefore supplement section II of our prior opinion with this opinion. Upon reexamination in light of VALIC's newly asserted right to alter past interest bands, we hold that VALIC's fixed annuity plan is a security subject to the federal securities laws.

The amount of discretion retained by VALIC to alter the interest it paid under the fixed annuity is relevant to the level of the investment risk assumed by VALIC. As discussed in our previous opinion, the Supreme Court, this circuit and the Securities and Exchange Commission (the "SEC") all have found that the degree of investment risk assumed by the insurance company is an important factor in determining whether a particular annuity plan is an insurance product or a security. The Supreme Court has stated that insurance "involves some investment risk-taking on the part of the company" and "a guarantee that at least some fraction of the benefits will be payable in fixed amounts." *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71, 79 S.Ct. 618, 622, 3 L.Ed.2d 640 (1959). The Court has also noted that there is "a basic difference between a contract which to some degree is insured and a contract of insurance." *S.E.C. v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211, 87 S.Ct. 1557, 1562, 18 L.Ed.2d 673 (1967); *see also Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Insurance Co.*, 698 F.2d 320 (7th Cir. 1983). The SEC recently enacted Rule 151 which defines more precisely what constitutes sufficient investment risk-taking by an insurance company to ensure that an annuity will be considered an insurance product and exempt from the federal securities laws pursuant to section 3 (a) (8) of the 1933 Securities Act. VALIC itself relied on the then proposed Rule 151 in its initial brief before this court. VALIC argued that "[a]lthough the Rule, even if adopted, would not apply to the product sold (between 1975 and 1982) to Otto and other class members, the . . . fixed annuity nonetheless largely satisfies the requirements contained in the proposed Rule. . . ." Defendants' Brief at 17.

The second of the three prongs of Rule 151 requires that "[t]he insurer assumes the investment risk under the contract" as further defined in the rule. In order for

the insurer to be "deemed to assume the investment risk" under the rule, the insurer must, among other things, "guarantee[] that the rate of any interest to be credited in excess of [the guaranteed minimum] . . . will not be modified more frequently than once per year." In its brief on rehearing, VALIC concedes that the fixed annuity does not satisfy this requirement given VALIC's claimed right to alter past interest bands. VALIC asserts that it has the absolute right to stop all excess interest payments on all deposits, past or present: "[E]xcess interest is wholly discretionary; with its unfettered discretion, VALIC can calculate excess interest by any method it chooses, it can elect to change the current interest rate paid on deposits, it can change the rates on past contributions, and (although competition makes it unlikely) it can stop paying excess interest altogether—at any time." Defendants' Brief on Rehearing at 8 (footnote omitted). A claimed right to change established excess interest rates and to eliminate excess interest payments entirely *at any time* surely tends to shift the investment risk from VALIC to the plan participant. VALIC, however, argues that its failure to meet this requirement of Rule 151 does not require a change in our prior determination that the fixed annuity qualified for the 3(a)(8) exclusion. VALIC argues that our prior conclusion that VALIC bears a sufficiently substantial risk "is solidly based on the substantiality of the *guaranteed* rates, a fact entirely independent of the availability of discretionary excess interest." *Id.* at 9 (emphasis in original).

The SEC in adopting Rule 151 rejected VALIC's view that guaranteeing a low minimum interest rate is a sufficient assumption of the investment risk by the insurance company. In Securities Act Release No. 6645 in which the SEC offers guidance in interpreting Rule 151, the SEC notes that several commentators suggested that the requirement of a one-year excess interest guarantee

be removed from the rule. The SEC rejected that suggestion and retained the one-year requirement, explaining its reasoning as follows:

> While the commentators make some reasonable arguments, the Commission is adopting the one-year requirement as proposed. Taking the position that various types of excess interest contracts are entitled to rely on the section 3(a)(8) exclusion is itself a major step. The length of time between interest rate modifications is one legitimate measure of the degree of investment risk assumed by the insurer. Designing a "safe harbor" rule is essentially a matter of balancing the legitimate interests of flexibility in structuring insurance products against the need to provide adequate investor protection. Where the limits of the "safe harbor" are set is a matter of discretion and judgment. The Commission believe, therefore, that the one-year period is, on balance, a reasonable condition, complementing the two other components of the rule's investment risk test.

Definition of Annuity Contract, Discussion Accompanying Enactment of Rule 151, Securities Act Release No. 6645, Fed.Sec.L.Rep. (CCH) ¶ 84,004, at 88,134 (May 29, 1986). We find that on the facts of this case the minimum interest rates guaranteed under VALIC's fixed annuity plan, although they are somewhat in excess of those required by Rule 151, alone do not place the investment risk on VALIC sufficiently to exempt the plan from the federal securities laws. To find otherwise we would have to overlook *entirely* any requirement for a guarantee of excess interest. To do this would be to disregard completely one element contained in the investment risk test of the SEC's safe harbor Rule 151. Admittedly this is not an element relied on previously in court decisions distinguishing securities from insurance products. But it is an element the SEC has insisted on over the objection of some commentators. Since Rule 151 was cited to

us by VALIC as a relevant test, we are unwilling to ignore it to the degree urged by VALIC. We therefore find that VALIC's fixed annuity plan is a security. On rehearing, we reverse the district court's order granting summary judgment for the defendants on the alleged violations of the Securities Exchange Act of 1934 and remand for further proceedings consistent with this opinion.

REVERSED AND REMANDED.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

June 10, 1987

Before

HON. WILLIAM J. BAUER, *Chief Judge*
HON. RICHARD D. CUDAHY, *Circuit Judge*
HON. KENNETH F. RIPPLE, *Circuit Judge*

Nos. 85-1816, 85-1819 and 85-2410

BEVERLY J. OTTO, individually, and on behalf of all others, similarly situated,
Plaintiff-Appellant,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, *et al.*,
Defendants-Appellees.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division

No. 82 C 4762—Marvin E. Aspen, *Judge*

ORDER AMENDING OPINION

The opinion in the above-entitled case, (814 F.2d at 1127), is amended as follows:

Immediately after the sentence "Because Rule 151 was cited to us by VALIC as a relevant test, we are unwilling to ignore it to the degree urged by VALIC," (814 F.2d at 1142), add the following language

We do not say that Rule 151 defines the meaning of "security"; it is a safe harbor rather than a definitional rule, as our first opinion observes, *see supra* at 1133 n.2. But VALIC's argument directly under the statute depends on its assertion that the guaranty of return here requires calling the instrument insurance under § 3(a)(8) even if the prospect of "excess" interest is a principal inducement to purchase this particular instrument. Because the contract actually leaves the investor with an investment risk significant enough to throw its status into doubt, VALIC's argument in this court effectively depended on its own analogy to the standards of Rule 151, which has not sufficed.

APPENDIX D

UNITED STATES DISTRICT COURT
N.D. ILLINOIS, E.D.

No. 82 C 4762

BEVERLY J. OTTO, Individually and on Behalf of all Others Similarly Situated,
Plaintiff,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, a Stock Life Insurance Company Organized Under the Laws of the State of Texas, CHARLES T. BAUER, MORTIMER M. CAPLIN, HENRY CHAUNCEY, HARRY C. COPELAND, JR., W. THOMAS FIQUET, FREDERICK M. GLASS, GRINNEL MORRIS, ROY T. PARKER, JR., ROBERT S. PHILLIPS, MICHAEL E. PUYANS, W. DAWSON STERLING, BENJAMIN N. WOODSON, PHILIP G. DAVIDSON III, ANDREW DELANEY, JOE F. FLACK, RICHARD H. HANNEMAN, HAROLD S. HOOK, MARDEN MILLER, JOHN J. PLUMB, GEORGE F. REED, ROBERT L. BALDWIN, STEPHEN D. BICKEL, TERRENCE J. CONLAN, JOE D. HEUSI, JOHN D. HOGAN, WILLIAM B. PARDUE, WILLIAM C. PHELPS, MICHAEL J. POULOS, ROBERT O. PURCIFULL, DIANE G. D'AGOSTINO, and GREGORY C. WILCOX, Individually Variable Annuity Life Insurance Company Separate Account One, and AMERICAN GENERAL CORPORATION,
Defendants.

April 11, 1985

MEMORANDUM OPINION AND ORDER

ASPEN, District Judge:

Plaintiff Beverly J. Otto ("Otto"), on behalf of herself and others similarly situated, brings this suit against the Variable Annuity Life Insurance Company ("VALIC") and certain affiliated companies and named directors of VALIC, alleging, *inter alia*, violations of the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.*; the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq.*; and the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961-1968. Otto essentially claims that the defendants have unlawfully failed to disclose to investors in VALIC's fixed annuity program the manner in which interest is calculated on their deposits, as well as the method by which investors can transfer their funds so as to maximize their rate of return. On March 15, 1984, the Court granted Otto's motion for class certification, permitting her to represent the class of all Illinois investors who participated in VALIC's fixed annuity program between October 17, 1975, and August 2, 1982. Presently before the Court is defendants' motion to strike and dismiss and for summary judgment. For the reasons set forth below, defendants' motion is granted.

Count I

Defendants offer several reasons why the complaint's securities fraud count fails to state a claim upon which relief can be granted and why defendants are entitled to summary judgment on that count as a matter of law. We need address only one of these reasons, defendants' assertion that the fixed annuity is not a security.

Defendants argue that VALIC's fixed annuity is not within the scope of the Securities Exchange Act of 1934 because it falls into the statutory exemption for "any

insurance or endowment policy or annuity contract or optional annuity contract" issued by a regulated insurance company. 15 U.S.C. § 77c(a)(8).[1] Otto, on the other hand, argues that VALIC's fixed annuity should be characterized as an "investment contract," one type of security defined in 15 U.S.C. § 78c(a)(10).[2] Although the term "investment contract" is a catch-all to bring within the securities acts various interests that have the functional attributes of stock and other formal securities but are not so denominated, *Peoria Union Stock Yards Company Retirement Plan v. Penn Mutual Life Insurance Co.*, 698 F.2d 320, 324 (7th Cir. 1983), we agree with defendants that the fixed annuity is more properly viewed as an insurance product than as an investment contract.

The contract under which Otto and the other class members became participants is designed for annuity

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[1] Indeed, although the statute refers to insurance policies and annuities as "exempted securities," they are probably more accurately considered not to be securities at all. *See* H.R.Rep. No. 85, 73d Cong., 1st Sess. 15; 3 H. Bloomenthal, Securities and Federal Corporate Law § 2.08[1] (1984 rev.).

[2] The "investment contract" provision is in fact the *only* part of the definition of "security" which arguably applies to this case. Section 78c(a)(10) provides:

> The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

purchase plans adopted by public school systems and certain tax-exempt organizations pursuant to Section 403 (b) of the Internal Revenue Code, 26 U.S.C. § 403(b). Under the contract's terms, participants may designate a portion of their salaries for deposit into either a variable or a fixed annuity account, and those amounts (up to a statutory maximum) are excluded from the participants' gross income for the year.

Since 1968, VALIC's *variable* annuity has been funded through Separate Account One, a diversified open-end management investment company registered under the Investment Company Act of 1940. Funds contributed by participants are segregated from VALIC's other assets and are invested primarily in a diversified portfolio of common stocks and other equity-type investments. The participants bear all the investment risks with this annuity; neither interest nor the principal contributed by the participants is guaranteed by the company. The participants' profits thus depend solely upon the expertise and investment success of those who invest the funds in the Separate Account.

The *fixed* annuity, the subject of this lawsuit, operates quite differently. Participants' contributions become a part of the company's general assets.[3] The stated primary objective of the fixed annuity is to provide insured retirement stability by long-term accumulation of funds through compound interest. VALIC bears the investment risk, because it guarantees the return of both principal and a minimum of 4% compound annual interest for the first ten years of participation and 3½% interest thereafter. Interest above the minimum level may be paid in the discretion of VALIC's board of directors.

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[3] As defendants point out, state insurance regulations strictly limit the types of investments which insurance companies can make. *See, e.g.*, Ill.Rev.Stat. ch. 73, ¶ 736 *et seq.* Therefore, the company's funds typically go into conservative debt-type securities, mortgages and bonds, with fixed rates of return.

Otto asserts that the status of VALIC's fixed annuity as a security is settled "beyond all question" by three cases: *SEC v. Variable Annuity Life Insurance Co. of America*, 359 U.S. 65, 79 S.Ct. 618, 3 L.Ed.2d 640 (1959); *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202, 87 S.Ct. 1557, 18 L.Ed.2d 673 (1967); and *Peoria Union Stock Yards*. These cases do shed some light on this issue, but they do not support, much less compel, the conclusion Otto reaches.

The Supreme Court decided long ago that a *variable* annuity offered by VALIC was a security. *VALIC*, 359 U.S. at 71, 79 S.Ct. at 622.[4] In doing so, the Court distinguished traditional fixed annuities from the more recently evolved variable annuities. *Id.*, 359 U.S. at 69, 79 S.Ct. at 621. Unlike their predecessors, variable annuities were to be treated as securities rather than insurance products, in large part because they placed the entire investment risk on the annuitant. "For in common understanding 'insurance' involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts." *Id.*, 359 U.S. at 71, 79 S.Ct. at 622.

The Supreme Court discussed the relationship between annuities and the federal securities laws further in *United Benefit*. That case involved a deferred, or optional, annuity plan called a "Flexible Fund Annuity" contract, under which the purchaser agreed to make certain annual contributions until a specified maturity date. The insurance company invested most of the Flexible Fund contributions in common stocks, with the object of producing capital gains as well as an interest return. "Instead of promising to the policyholder an accumulation to a fixed amount of savings at interest, the insurer promise[d] to serve as an investment agency

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[4] We note once again that it is VALIC's fixed, and not variable, annuity which is at issue in this case. Otto occasionally blurs the distinctions between the two, both in the complaint and in her brief opposing defendants' motion.

and allow the policyholder to share in its investment experience." *United Benefit*, 387 U.S. 202, 208, 87 S.Ct. 1557, 1560. Upon maturity the purchaser could either withdraw his contributions, plus the earnings that had accumulated through the insurer's investment of those contributions, or use them to purchase an annuity from the company. Whatever his choice, the purchaser was guaranteed a low minimum value (with no interest component) at maturity.

The Court found that the accumulation portion of this annuity plan was an investment contract rather than an insurance product. Although the cash value guarantee reduced somewhat the investment risk of the purchaser, this was not enough. The Court stated that "'[t]he test . . . is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.'" *Id.*, 387 U.S. at 211, 87 S.Ct. at 1562, quoting *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 352-53, 64 S.Ct. 120, 124, 88 L.Ed. 88 (1943). The Flexible Fund was "considered to appeal to the purchaser not on the usual insurance basis of stability and security but on the prospect of 'growth' through sound investment management." *United Benefit*, 387 U.S. at 211, 87 S.Ct. at 1562. Given the plan's pitch to growth through professionally managed investment, the Court deemed it fair to apply the securities laws to it. *Id.*

VALIC's fixed annuity differs significantly from the plans in these two Supreme Court cases. VALIC bears the investment risk, guaranteeing the return of the participants' contributions plus interest. Moreover, the economic inducement of the fixed annuity is indeed the "usual insurance basis of stability and security" rather than growth through investment. The company's literature clearly emphasizes the different objectives of the variable and fixed annuities: the former is "long-term capital growth," which the latter is the more secure

"long-term accumulation of funds for retirement through compound interest." *See, e.g.*, VALIC's *Owner's Manual*, Exhibit B to Otto's complaint. The stability of the fixed annuity was apparent to Otto, who stated that she chose this annuity instead of the variable annuity because she did not like "the fluctuating rates" and wanted "a more conservative investment." Otto deposition, p. 25.[5] Accordingly, VALIC's fixed annuity is distinguishable from the annuities which the Supreme Court has found to be within the reach of the securities laws.

Nor does the Seventh Circuit opinion in *Peoria Union Stock Yards* bolster Otto's claim that the fixed annuity should be treated like a security. That case dealt with a "group deposit administration annuity contract" sold by an insurance company to pension trustees. The insurance company guaranteed interest payments (at a rate declining from 7½% to 3½%) on contributions made during the first three years of the contract, but it made no guarantee on later contributions. *All* the contributions, however, were to be credited with whatever investment income the insurance company could realize, less certain modest administrative charges. Thus, the Seventh Circuit found that the insurance company bore even less of the investment risk than did the company in *United Benefit*, and that any profits of the enterprise were due solely to the investment efforts of the insurance company. *Peoria Union Stock Yards*, 698 F.2d at 325. This plan is thus distinguishable from VALIC's fixed annuity in the same way as the contracts in *VALIC*

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[5] Otto asserts in her response brief that the guaranteed rates of interest were hardly enough to attract anyone to the contract and that the incentive was the discretionary interest payable. This assertion ignores the substantial pecuniary benefits of excluding the contribution amounts from gross income for tax purposes and is belied by Otto's stated aversion of "fluctuating rates" (the discretionary interest, of course, was just that—discretionary—and could be varied or omitted at any time).

and *United Benefit*—"the insurance company is offering the pension plan a chance to share in the insurance company's investment experience." *Id.* VALIC offers this chance to its customers through the variable, not the fixed, annuity.

Our decision that VALIC's fixed annuity is not a security is supported by the SEC's view that "neither the general account nor any interests therein are generally subject to the provisions of the 1933 or 1940 Acts. . . ." [6] Although not controlling, the Commission's interpretation of the securities laws is entitled to considerable weight. *United States v. National Association of Securities Dealers, Inc.*, 422 U.S. 694, 718-19, 95 S.Ct. 2427, 2442, 45 L.Ed.2d 486 (1975).

Accordingly, we hold that Otto's securities fraud claim must fail because VALIC's fixed annuity is not a security.

Count II

Defendants make a two-pronged attack on the complaint's ERISA count. First, they argue that ERISA does not cover VALIC's fixed annuity because the annuity is not "employer maintained"—and ERISA applies only to plans or funds "established or maintained by an employer." 29 U.S.C. §§ 1002(2)(A), 1003(a).[7] Second, defendants argue that even if the fixed annuity were considered to be "employer maintained," the annuity would be excluded from ERISA's coverage because Otto's employer is a governmental subdivision. 29 U.S.C.

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[6] *See* letter of January 31, 1984, to VALIC from Thomas E. Neal, Assistant Chief of the SEC's Office of Insurance Products and Legal Compliance, attached to defendants' supporting brief.

[7] Section 1002(2)(A) provides in pertinent part: "[T]he terms 'employee pension benefit plan' and 'pension plan' mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both. . . ."

§§ 1002(32), 1003(b)(1). Defendants' first argument is persuasive.[8]

Both Otto and defendants agree that the school district does no more than: (1) permit annuity contractors to publicize their products to employees, and (2) collect and remit to contractors the contributions designated by participating employees. These minimal, ministerial activities do not render VALIC's fixed annuity plan one "established or maintained" by the school district.[9] VALIC's annuity therefore does not fall within the statutory definition of "employee pension benefit plan" or "employee benefit plan" and therefore is not covered by ERISA. The ERISA claims of Otto and all other members of the plaintiff class must be dismissed.[10]

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[8] Most of Otto's response is devoted to defendants' second argument. In contending that no governmental exemption applies to VALIC's fixed annuity, Otto emphasizes the fact that the annuity plan is not established or maintained by her school district employer, but rather is formulated and completely controlled by VALIC. While this vitiates defendants' second argument, it strengthens their first.

[9] This conclusion is in accord with a Department of Labor regulation, 29 C.F.R. § 2510.3-2(f), which explains that tax sheltered annuities such as VALIC's shall not be deemed to be "established or maintained by an employer" when the employer's involvement is limited (as in this case). Otto's arguments that we should disregard this regulation are unconvincing.

[10] After defendants filed the reply brief for their motion, Otto filed a motion seeking leave to add three additional persons as named plaintiffs in this action. Otto's motion was clearly a response to defendant's governmental exemption argument, as the three putative additional class representatives are employees of a private, non-governmental entity. However, their inclusion in this suit would have no effect—the ERISA claim is dismissed *not* because Otto's employer is a governmental subdivision, but because the annuity plan is not established or maintained by the employer (whether it be governmental or non-governmental). Accordingly, Otto's motion is denied.

Count III

Otto alleges in Count III that each of the thirty-one individual and four corporate defendants have violated the civil RICO statute. She claims that the defendants went astray from 18 U.S.C. § 1962(c), which prohibits a person from conducting the affairs of an enterprise that is engaged in, or whose activities affect, interstate commerce through a "pattern of racketeering activity." Section 1961 defines a pattern of racketeering activity as at least two occurrences within ten years of any of several predicate offenses, including mail fraud, bribery and fraud in the sale of securities.

The Seventh Circuit recently discussed the elements of a section 1962(c) claim in *Haroco, Inc. v. American National Bank and Trust Co. of Chicago*, 747 F.2d 384 (7th Cir. 1984), *cert. granted*, —— U.S. ——, 105 S.Ct. 902, 83 L.Ed.2d 917 (1985):

> To allege a violation of section 1962(c), the plaintiff must allege that the defendant (1) was employed by or associated with (2) an enterprise engaged in, or the activities of which affected, interstate or foreign commerce, and (3) that the person conducted or participated in the conduct of the enterprise's affairs (4) through a pattern of racketeering activity.

Id., 747 F.2d at 387. Defendants claim that Otto's allegations are deficient in various respects, requiring dismissal of the RICO count. We agree with at least two of defendants' arguments.

Defendants first argue that the RICO count is fatally defective because it fails to identify any "enterprise." Indeed, the complaint uses the term "enterprise" twice (in paragraphs 74 and 75), but nowhere explains what enterprise was involved. Otto's response brief does nothing to clear up matters; to the contrary, it simply states at different points that the enterprise *might* be VALIC or VAMCO or a board of directors or an asso-

ciation in fact of the individual defendants and "the corporation." [11]

To establish an enterprise, Otto must plead and prove that "the various associates function[ed] as a continuing unit" and that the enterprise existed "separate and apart from the pattern of activity in which it engage[d]." *United States v. Turkette*, 452 U.S. 576, 583, 101 S.Ct. 2524, 2528-29, 69 L.Ed.2d 246 (1981). Moreover, the same individual or corporation may not be both the liable "person" and the "enterprise" under section 1962(c). *Haroco*, 747 F.2d at 400. Unless Otto specifies the enterprise involved in this case, it is impossible to determine if she has satisfied these other requirements as to each of the defendants. Accordingly, the RICO claim as stated in Count III is insufficient. *E.g.*, *Bennett v. Berg*, 685 F.2d 1053, 1061-62 (8th Cir. 1982), *aff'd in part and rev'd in part*, 710 F.2d 1361 (8th Cir. 1983) (en banc), *cert. denied*, —— U.S. ——, 104 S.Ct. 527, 78 L.Ed.2d 710 (1983); *see also Laterza v. American Broadcasting Co., Inc.*, 581 F.Supp. 408, 414 (S.D.N.Y. 1984) (general assertion that combination of defendants constituted an "enterprise," without allegation as to continuity of structure or personnel, was insufficient).

Defendants also point out a second, perhaps greater deficiency—Otto's failure to specify each defendant's role in a "pattern of racketeering activity." The complaint refers to three kinds of predicate offenses which might be a part of such a pattern: mail fraud, wire fraud (which Otto incorrectly calls "false pretenses"), and violations of the federal securities laws. As explained above, Otto has failed to state a claim for any securities laws violation. Thus, to establish a pattern of racketeering activity, Otto must allege at least two instances of mail or wire fraud.

There is little doubt that Fed.R.Civ.P. 9(b), which requires that allegations of fraud specify "with particular-

[11] It is not at all clear which corporation Otto means.

ity" the circumstances of the alleged fraud, applies to fraud allegations in civil RICO complaints. *Haroco*, 747 F.2d at 405. Defendants contend that Otto has not satisfied Rule 9(b) because she fails to identify any allegedly false documents and fails to specify how any of the defendants were involved in sending any documents. We disagree with defendants' first contention, as the complaint refers to (and attaches as exhibits) three specific "investment prospectuses, financial and interest statements." Complaint, paragraph 73(a). However, we do agree with defendants' second contention, that the complaint fails to sufficiently plead each defendant's respective involvement in any fraudulent activity. In fact, the complaint is devoid of *any* factual allegations concerning particular defendants. The complaint's conclusory allegations, which merely attribute fraudulent representations to thirty-five defendants collectively, are not specific enough to satisfy Rule 9(b). *Hudson v. La Rouche*, 579 F.Supp. 623, 628-29 (S.D.N.Y. 1983); *D & G Enterprises v. Continental Illinois National Bank and Trust Company of Chicago*, 574 F.Supp. 263, 267 (N.D. Ill. 1983). The inadequacy of the fraud allegations is especially great regarding the individual defendants, many of whom left VALIC before 1978 or joined VALIC after the purportedly fraudulent documents were issued. Accordingly, the complaint's RICO count is dismissed.

Count IV

In Count IV, Otto alleges that all the defendants conspired to violate the Securities Exchange Act of 1934, ERISA and RICO, the same statutes on which she relies in Counts I, II and III. At a minimum, a conspiracy requires allegations and proof of one overt act by a defendant in furtherance of the conspiracy, and the assent of each defendant to the operation of the conspiracy. *United States v. Sutherland*, 656 F.2d 1181, 1186-87 n. 4 and 1193 (5th Cir. 1981), *cert. denied*, 455 U.S. 949, 102 S.Ct. 1451, 71 L.Ed.2d 663 (1982). The defendants ar-

gue that Otto's allegations fail to meet even this minimum requirement. We agree.

It may be theoretically possible for defendants to have conspired to violate RICO or even the federal securities laws or ERISA (which, as explained above, defendants actually could not have violated).[12] However, general allegations of a conspiracy which are unsupported by facts are not enough to state a cause of action. *Saine v. A.I.A., Inc.*, 582 F.Supp. 1299, 1307 (D.Colo. 1984). The allegations in Count IV are even sketchier than those in Count III, which we have found inadequate to state a RICO claim against any particular defendant. There are simply no facts alleged which permit a reasonable inference that the dozens of defendants, many of whom were no longer affiliated with VALIC when other defendants *began* their association with the company, ever assented to a conspiracy to violate various federal laws. Thus, Count IV fails to state a cause of action and must be dismissed.

Counts V and VI

In Counts V and VI, Otto asserts two state law claims: breach of contract and common law fraud. Because the federal claims in Counts I through IV are all dismissed, there is no longer any basis for this Court to exercise pendent jurisdiction over the state law claims. *United Mineworkers of America v. Gibbs*, 383 U.S. 715, 725-26, 86 S.Ct. 1130, 1138, 16 L.Ed.2d 218 (1966); *Americana Healthcare Corp. v. Schweiker*, 688 F.2d 1072, 1087 (7th Cir. 1982), *cert. denied*, 459 U.S. 1202, 103 S.Ct. 1187, 75 L.Ed.2d 434 (1983). Therefore, these counts are dismissed as well.

Accordingly, defendants' motion to strike and dismiss and for summary judgment is granted. It is so ordered.

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[12] *See, e.g., United States v. Rose*, 590 F.2d 232, 235-36 (7th Cir. 1978), *cert. denied*, 442 U.S. 929, 99 S.Ct. 2859, 61 L.Ed.2d 297 (1978) (legal or factual impossibility of committing offense not a defense to conspiracy claim).

APPENDIX E

No. 82 C 4762

United States District Court
N.D. Illinois, E.D.

Aug. 2, 1985

BEVERLY J. OTTO, Individually and on Behalf of all Others Similarly Situated,
Plaintiffs,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, a Stock Life Insurance Company Organized Under the Laws of the State of Texas, CHARLES T. BAUER, MORTIMER M. CAPLIN, HENRY CHAUNCEY, HARRY C. COPELAND, JR., W. THOMAS FIQUET, FREDERICK M. GLASS, GRINNEL MORRIS, ROY T. PARKER, JR., ROBERT S. PHILLIPS, MICHAEL E. PUYANS, W. DAWSON STERLINE, BENJAMIN N. WOODSON, PHILIP G. DAVIDSON III, ANDREW DELANEY, JOE F. FLACK, RICHARD H. HANNEMAN, HAROLD S. HOOK, MARDEN MILLER, JOHN J. PLUMB, GEORGE F. REED, ROBERT L. BALDWIN, STEPHEN D. BICKEL, TERRENCE J. CONLAN, JOE D. HEUSI, JOHN D. HOGAN, WILLIAM B. PARDUE, WILLIAM C. PHELPS, MICHAEL J. POULOS, ROBERT O. PURCIFULL, DIANE G. D'AGOSTINO, and GREGORY C. WILCOX, Individually Variable Annuity Marketing Company, the VARIABLE ANNUITY LIFE INSURANCE COMPANY SEPARATE ACCOUNT ONE and AMERICAN GENERAL CORPORATION,
Defendants.

MEMORANDUM ORDER

ASPEN, District Judge:

Plaintiff's second motion to reconsider and for leave to amend her complaint is denied.

On April 11, 1985, the Court, 611 F.Supp. 83, granted defendants' motion for summary judgment on Counts I and II and dismissed the remainder of plaintiff's amended complaint. Plaintiff filed her first motions for reconsideration and for leave to file a second amended complaint on April 19, 1985. However, plaintiff filed no proposed second amended complaint at that time. On April 26, 1985, the Court denied plaintiff's motions.

Plaintiff filed the motion now before the Court, her second motion to reconsider and for leave to amend the complaint (along with a copy of the proposed pleading), on May 10, 1985. She also filed that day a notice of appeal to the United States Court of Appeals for the Seventh Circuit from the final judgment entered on April 11, 1985, and the order of April 26, 1985—the two rulings she asks this Court to reconsider.

A.

We first note that although plaintiff claims that her motion comes under Fed.R.Civ.P. 60(b), it is properly viewed as a motion to alter or amend a judgment as allowed under Rule 59(e). Plaintiff essentially asks this Court to correct errors of law; this is not the type of "mistake" referred to in Rule 60(b) but falls within the scope of Rule 59(e). *See, e.g., United States Labor Party v. Oremus*, 619 F.2d 683, 687 (7th Cir. 1980); *Dove v. Codesco*, 569 F.2d 807, 809 (4th Cir. 1978).[1]

Motions under Rule 59(e) must be filed within ten days after entry of judgment, and district courts may not extend this deadline. *Textile Banking Co., Inc. v. Rentschler*, 657 F.2d 844, 849 (7th Cir. 1981). However,

[1] Moreover, plaintiff herself originally treated her motions to reconsider as if they were Rule 59(e) motions. She has acknowledged the Rule's ten-day deadline, both by filing her first motion within that time period and by explaining in her second motion why her counsel was unable to prepare a proposed second amended complaint within ten days after April 11, 1985.

plaintiff did not file her second motion to reconsider within ten days—it came twenty-nine days after the Court's April 11 decision and fourteen days after the April 26 ruling. On this basis alone, plaintiff's motion must be denied.

B.

Defendants also argue that plaintiff's motion should be denied because she divested this Court of jurisdiction over the matter when she filed her notice of appeal on May 10, 1985. In general, the filing of an appeal vests jurisdiction in the court of appeals, and further proceedings in the district court cannot take place without leave of the appellate court. *Asher v. Harrington*, 461 F.2d 890, 895 (7th Cir. 1972). In this case, the Seventh Circuit has ordered that briefing in plaintiff's appeal shall be held in abeyance pending further order of the Court of Appeals, and that plaintiff's counsel is to report to the Seventh Circuit as to this Court's ruling on plaintiff's motion to reconsider. This order might be construed as granting (though not explicitly) this Court leave to proceed further in deciding plaintiff's motion on the merits. More likely, the Seventh Circuit's order expresses no opinion on the question and leaves it to this Court to decide whether or not it has jurisdiction over plaintiff's motion any longer. If the latter be the case, we agree with defendants that plaintiff's appeal has vested jurisdiction solely in the Seventh Circuit.

Under Fed.R.App.P. 4(a)(4), a notice of appeal has no effect if it is filed before disposition of a timely post-trial motion (including one under Fed.R.Civ.P. 59). However, as explained in Part A above, plaintiff's motion was not timely—it was filed more than ten days after the entry of judgment. *See* 6A J. Moore, Moore's Federal Practice ¶ 59.13[3] (2d ed. 1984). Plaintiff's notice of appeal is therefore effective and divests the Court of jurisdiction.

Moreover, the pending motion seeks reconsideration of the Court's order denying plaintiff's first motion to reconsider. A *second* motion to reconsider should not be deemed a timely Rule 59 motion, even if filed within ten days (which is not the case here). 9 J. Moore, Moore's Federal Practice ¶ 204.12[1] (2d ed. 1985) ("Both the text and purpose of Rule 4(a)(4) indicate that it is an *original* motion of the types specified that postpones appeal until after disposition of the motion and the running of the time for appeal is not further extended by a motion to reconsider an order disposing of the motion. . . .") (footnote omitted and emphasis in original). Because plaintiff filed an effective appeal, her second motion to reconsider must be dismissed for lack of jurisdiction.

C.

Even if plaintiff's motion were timely and this Court had not been divested of jurisdiction by plaintiff's notice of appeal, the motion should be denied. Nothing in plaintiff's motion or memoranda convinces us that our earlier rulings were in error.

Our decision that the fixed annuity in this case should not be deemed a security is not contradicted by the Seventh Circuit's holding in *Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484 (7th Cir. 1984). *Hunssinger* involved the purchase of notes by a profit sharing trust, not the purchase of a fixed annuity. This distinction is significant: "note" is the first term listed in the statutory definition of security, 15 U.S.C. § 78c(a)(10), while an "annuity contract" issued by a regulated insurance company is considered to be an exempted security, 15 U.S.C. § 77c(a)(8).[2] Moreover, the Seventh Circuit's

[2] The Court of Appeals stated that "an instrument that does not pass the investment contract test may still be a security if it falls under one of the other specific statutory terms." *Hunssinger*, 745 F.2d at 491. "Note" is one such statutory term; "annuity" is not.

decision was based on the repeated reference to the note as an investment and on the district court's failure to look beyond the document and consider the facts surrounding the promotion and purchase. Contrary to plaintiff's assertion, this Court did indeed consider "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect," *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211, 87 S.Ct. 1557, 1562, 18 L.Ed.2d 673 (1967), in deciding that defendants' fixed annuity was more akin to an insurance product than an investment contract.

Plaintiff's contention concerning her ERISA count merits little response. She cites no authority supporting her claim that our holding necessarily affects the tax deductibility of payments for the fixed annuity, and we do not see the logic of her position. Two different statutes with different purposes are involved; our holding that the fixed annuity plan is not "established or maintained" by plaintiff's employer for the purposes of ERISA should have no effect on the status of her payments under the Internal Revenue Code.

Once more, we decline to reconsider our application of Rule 9(b) to Counts III and IV. Plaintiff's first amended complaint is distinguishable from the complaint we considered in *Swanson v. Wabash, Inc.*, 577 F.Supp. 1308 (N.D.Ill. 1983), and in fact is more similar to those found to be insufficient in *D & G Enterprises v. Continental Illinois National Bank and Trust Co. of Chicago*, 574 F.Supp. 263 (N.D.Ill. 1983), and *Lincoln National Bank v. Lampe*, 414 F.Supp. 1270 (N.D.Ill. 1976). Thus, plaintiff's second motion to reconsider is denied in its entirety.

D.

Plaintiff's second motion for leave to file another amended complaint should also be denied.

First, plaintiff incorrectly claims that she has satisfied all the requirements set forth by the Seventh Circuit in the recent case of *Twohy v. First National Bank of Chicago*, 758 F.2d 1185 (7th Cir. 1985). The Court of Appeals in *Twohy* explained the different standards governing post-judgment and pre-judgment amendments of a complaint: although even after entry of judgment on dismissal "leave [to amend] shall be freely given when justice so requires," Fed.R.Civ.P. 15(a) "justice may require something less in post-judgment situations." *Id.* at 1195-96. The Seventh Circuit repeated its previous holding that

> once a district court enters judgment upon a dismissal (as opposed to a mere dismissal of the complaint), the plaintiff may amend the complaint under Rule 15(a), Fed.R.Civ.P., solely with "leave of court" after a motion under Rule 59(e) or 60(b), Fed.R.Civ.P., has been made and the judgment has been set aside or vacated. *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1111 (7th Cir. 1984), *cert. denied*, —— U.S. ——, 105 S.Ct. 1758, 84 L.Ed.2d 821 (1985). The right under Rule 15(a) to amend "once as a matter of course" is lost after the entry of judgment. *Id.*

Id. at 1196. As explained in Parts A-C above, plaintiff's motions to reconsider have been denied. Because the judgment has not been set aside or vacated, plaintiff may not amend her complaint again. Moreover, like the plaintiff in *Twohy*, plaintiff failed to file a proposed amended complaint with her first Rule 59(e) motion to amend the judgment order and request for leave to file an amended complaint.[3] Thus, plaintiff did not comply with the re-

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[3] Plaintiff's explanation of how busy her counsel was is unavailing. Twenty-nine days passed between the entry of judgment and the filing of a proposed second amended complaint, and the Seventh Circuit has stated that a failure to tender a proposed pleading

quirements for post-judgment amendments described in *Twohy*.

Second, plaintiff's proposed second amended complaint is not offered in good faith. In our April 26, 1985 order denying plaintiff's first motion to amend, we noted that plaintiff not only failed to attach a proposed pleading but also that she

> suggest[ed] that her second amended complaint would respond to "only the *first* motions attacking the Complaint." While it is not clear just what plaintiff intends by this qualification, an amended complaint which disregarded some of defendants' motions and/or this Court's rulings on such motions would not even constitute a good faith effort by plaintiff.

Notwithstanding this admonition, plaintiff repeated her cryptic qualification in her second motion to reconsider and for leave to amend. Motion ¶ 7.

Plaintiff has also failed to conform her proposed second amended complaint to this Court's earlier rulings in several other ways. For example, the proposed complaint lists three individuals besides Otto as named plaintiffs and class representatives in spite of the fact that this Court clearly denied Otto's motion to add them as parties. April 11, 1985 at 88 n. 10. Although the Court certified a class of all Illinois fixed annuity participants between October 17, 1975 and August 2, 1982, plaintiff purports to expand the class beyond June of 1984. Neither Counts I nor II conform in the least to the Court's summary judgment rulings. Count III, among other things, names the same corporation as the liable "person" and the "enterprise" under 18 U.S.C. § 1962(c), although this Court earlier made it clear that this was

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with a Rule 15(a) motion to amend "certainly indicates a lack of diligence and good faith." *Twohy*, 758 F.2d at 1197 (footnote omitted).

impermissible. April 11, 1985 at 89. These blatant deviations (and others) from the Court's prior decisions in this case demonstrate a lack of good faith which justifies denying plaintiff's second motion to amend.

Third, once a motion to dismiss (or for summary judgment) has been granted, the district court need not allow an amendment that does not cure the defects of the original complaint. *Textor v. Board of Regents of Northern Illinois University*, 711 F.2d 1387, 1391 n. 1 (7th Cir.1983); *Stebbins v. Weaver*, 537 F.2d 939, 942 (7th Cir.1976), *cert. denied*, 429 U.S. 1041, 97 S.Ct. 741, 50 L.Ed.2d 753 (1977); *see also Verhein v. South Bend Lathe, Inc.*, 598 F.2d 1061, 1063 (7th Cir.1979) (court may deny leave to amend where proposed amendment fails to allege facts which would support a valid theory of liability or where moving party has not shown that proposed amendment has substantial merit).

In Count I, plaintiff has simply stopped calling three documents the "Fixed Annuity Plan" and begun referring to them instead as the "Tax Deferred Investment Program." This change in labels, however, does nothing to alter the Court's analysis of the documents themselves or the law relating to them. Also added to plaintiff's securities claim is an alleged § 10(b) violation concerning the tax status of the annuities (in light of this Court's decision regarding ERISA). As stated above, we find this argument of plaintiff's to be illogical; it does not support a valid theory of liability. *Verhein*, 598 F.2d at 1061.

Similarly, plaintiff's proposed Count II alleges no new facts which would require the Court to reconsider its earlier decision. *Stebbins*, 537 F.2d at 942.

Counts III and IV still suffer the same deficiencies as before. Although plaintiff names VAMCO as the enterprise, she uses this label inconsistently. We have already noted that VAMCO is improperly named as both the

enterprise and person liable. Moreover, plaintiff suggests in her supporting memorandum that the "VALIC family" or the "American General Family" are the true enterprises in this case. The second amended complaint proposed by plaintiff also is still wholly insufficient in pleading with the specificity required by Fed.R.Civ.P. 9(b) the involvement of each defendant in any fraudulent activity. The inclusion of several documents purported to be instances of mail fraud does not cure this defect. Likewise, Count IV fails to allege a conspiracy claim against any of the particular defendants.

Because plaintiff is not entitled to post-judgment amendment as explained in *Twohy*, and because the proposed second amended complaint is not offered in good faith and would be futile, plaintiff's second motion for leave to amend her complaint is denied.

Plaintiff's second motion to reconsider and for leave to amend her complaint is denied on three bases: (1) the motion is untimely; (2) plaintiff's notice of appeal divests this Court of jurisdiction; and (3) the motion should be denied on the merits. It is so ordered.

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60064

April 15, 1987

Before

HON. WILLIAM J. BAUER, *Chief Judge*
HON. RICHARD D. CUDAHY, *Circuit Judge*
HON. KENNETH F. RIPPLE, *Circuit Judge*

Nos. 85-1816, 85-1919, and 85-2410

BEVERLY J. OTTO, individually, and
on behalf of all others similarly situated, *et al.*,
Plaintiffs-Appellants,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, *et al.*,
Defendants-Appellees.

Appeals from the United States District Court for the
Northern District of Illinois, Eastern Division

No. 82 C 4762—Marvin E. Aspen, Judge

AMENDED JUDGMENT ORDER

This cause was heard on the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED IN PART, REVERSED AND REMANDED IN PART, in accordance with the opinions of this Court of December 8, 1986 and April 15, 1987. Costs on appeal are awarded to plaintiffs-appellants.

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60064

June 15, 1987

Before

HON. WILLIAM J. BAUER, *Chief Judge*
HON. RICHARD D. CUDAHY, *Circuit Judge*
HON. KENNETH F. RIPPLE, *Circuit Judge*

Nos. 85-1816, 85-1919, and 85-2410

BEVERLY J. OTTO, individually, and
on behalf of all others similarly situated, *et al.*,
Plaintiffs-Appellants,

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY, *et al.*,
Defendants-Appellees.

Appeals from the United States District Court for the
Northern District of Illinois, Eastern Division

No. 82 C 4762—Marvin E. Aspen, Judge

ORDER

On consideration of the petition for rehearing *en banc* filed by the defendants-appellees in the above-entitled cause, no judge in active service has requested a vote thereon. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing *en banc* be, and the same is hereby, DENIED.

APPENDIX H

1. Section 3(a)(8) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(8), provides:

> (a) Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of securities:
>
> * * * *
>
> (8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.

2. Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) provides:

> (a) When used in this chapter, unless the context otherwise requires—
>
> * * * *
>
> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any

instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

3. Sections 1 and 2 of the McCarran-Ferguson Act, 15 U.S.C. §§ 1011 and 1012, provide:

§ 1011

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal

Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

4. SEC Rule 151, 17 C.F.R. § 230.151, 51 Fed. 20,254, 20,262 (June 4, 1986), provides:

> (a) Any annuity contract or optional annuity contract (a "contract") shall be deemed to be within the provisions of section 3(a)(8) of the Securities Act of 1933 (15 U.S.C. 77c(a)(8)), *Provided*, That
>
> > (1) The annuity or optional annuity contract is issued by a corporation (the "insurer") subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia;
> >
> > (2) The insurer assumes the investment risk under the contract as prescribed in paragraph (b) of this section; and
> >
> > (3) The contract is not marketed primarily as an investment.
>
> (b) The insurer shall be deemed to assume the investment risk under the contract if:
>
> > (1) The value of the contract does not vary according to the investment experience of a separate account;
> >
> > (2) The insurer for the life of the contract
> >
> > > (i) Guarantees the principal amount of purchase payments and interest credited thereto, less any deduction (without regard to its timing) for sales, administrative or other expenses or charges; and
> > >
> > > (ii) Credits a specified rate of interest (as defined in paragraph (c) of this section) to

net purchase payments and interest credited thereto; and

(3) The insurer guarantees that the rate of any interest to be credited in excess of that described in paragraph (b) (2) (ii) of this section will not be modified more frequently than once per year.

(c) The term "specified rate of interest," as used in paragraph (b) (2) (ii) of this section, means a rate of interest under the contract that is at least equal to the minimum rate required to be credited by the relevant nonforfeiture law in the jurisdiction in which the contract is issued. If that jurisdiction does not have any applicable nonforfeiture law at the time the contract is issued (or if the minimum rate applicable to an existing contract is no longer mandated in that jurisdiction), the specified rate under the contract must at least be equal to the minimum rate then required for individual annuity contracts by the NAIC Standard Nonforfeiture Law.

APPENDIX I

SUPREME COURT OF THE UNITED STATES

No. A-171

VARIABLE ANNUITY LIFE INSURANCE COMPANY *et al.*,
Applicants,

v.

BEVERLY J. OTTO, ETC.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for the applicants,

IT IS ORDERED that the time for filing a petition for a writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including October 13, 1987.

/s/ John Paul Stevens
Associate Justice
of the Supreme Court
of the United States

Dated this 28th day of August, 1987.

APPENDIX J

American General Corporation owns the following subsidiaries, which are involved in the joint ventures listed below:

AGC Resources, Inc.
- Highland Resources, Inc.

American General Corporation
- Woodham Joint Venture

American General Investment Corporation
- Appelt Prop. No. 1, Ltd.

American General Life & Accident Insurance Company
- Fulcrum II, L.P.
- Institutional Venture Partners, L.P.
- Institutional Venture Partners II, L.P.
- Morgan Stanley Leveraged Mezzanine Fund, L.P.

American General Life Insurance Company
- American General Health Club

American General Life Insurance Company of Delaware
- America Tower
- Cypress Crossing Venture
- Mosbacher—A. G. Company

American General Life Insurance Company of New York
- Highland Resources, Inc. 1984
- One Park Place Associates

American General Realty Company
- Allen Center Co.
- Allen Center Co. #2
- Allen Center Co. #3

Atlas Realty Company
- Charter Associates

Cinco Ranch Venture
Cutten Associates
Cypress Associates
Deer Valley Industrial Center
Encanto Business Park
Hickory Down Venture
Langham Associates
The Meadows Venture
One Arlington Center
Pecan Grove Associates
Treaschwig Associates

California-Western States Life Insurance Company
America Tower
Cal-Mira Mesa, Ltd.
Cal-Sorrento, Ltd.
Sunrise Mall Associates
Vagabond Glendale Motor Hotel
Vagabond Sunnyvale Motor Hotel
Warburg-Pincus LTD.

Georgetown Realty, Inc.
Lake Wylie

Gulf Village, Inc.
Wharfside II

Gulfco Capital Management, Inc.
Soujourn/Westgrove Off/Serv. Bldg.

Hadco, Inc.
Columbia Square
Duo Mercatum

Intereal Company
Boone-Southern
Carlton Arms of Egypt Lake
Hickory Hollow Associates
Koll/Intereal Bay Area
Koll/Intereal Northwest
Koll/Intereal Phoenix

Koll/Intereal Portland
Koll/Irvine Business Center
Koll National
Koll National Cypress
Koll National North
Newmarket North
Newmarket South
Norcal Associates
Sammis Diamond Bar II
Sammis Diamond Bar III
Santa Fe Springs Business Park
West Georgia Common Associates
West Lake Arms

Jovencal Realty, Inc.
Kollreal
Oak Meadows Properties

Joventex Corporation
Camino Real Apartments
Cinco Venture

Life and Casualty Insurance Company of Tennessee
Alamo II
America Tower
American General Health Club
No. 1 Beach Street

Rylis Realty Company
Columbia 205 Commerce Center
Fairbanks Associates
Glencairn Village
Jackrabbit Venture
Overlake Commercial Center
Riverbrook Associates

Tennessee Vintage Corporation
Vintage Faire Associates